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Research Articles
Globalizing the Chinese Social Assistance Program:
The Authoritarianism That Listens?

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Abstract
Can an authoritarian regime, lacking institutionalized channels of representation, listen to its subjects in a similar way a democracy does? To answer this question, this study examines China’s welfare change in the past decades, which has been characterized by the government’s effort toward a balanced distribution of benefits across social sectors. Curiously, however, such a move has occurred without significant political change that would lead to the shift of power distribution among these sectors, a condition presumably critical for welfare redistribution. What, then, has persuaded the government to redistribute welfare benefits towards politically disadvantaged social sectors such as the urban and rural poor through institutionalized manner that would tie their own hands for long-term commitment? This study offers an endogenous model to highlight the importance of the structural change introduced by the interaction of China’s economic integration and its geopolitical constraints in inducing the authoritarian ruler to listen to the demand of its subjects. It also sheds new lights on our understanding of the nature of Chinese regime and its transition.

Keywords: China, social assistance, authoritarianism, globalization, systemic vulnerability

1. Introduction
Authoritarian regimes are not known for listening to their subjects, particularly to those politically marginalized social groups. When the situation gets sour and they have to pay attention, authoritarian rulers commonly resort to two instruments in their toolbox of political control: repression and bribe. Whenever force becomes too costly, cash benefits would buy off the dissatisfied population at rough times.
It is against this common perception that China’s recent development of welfare protection for the poorest seems puzzling to the conventional understanding of authoritarian regimes. The figure below shows the changing trend of the social assistance program targeting the very poor in urban and rural areas and the traditional pension program for retired government employees at both the central and local levels. Whereas the spending level for the latter group have fluctuated over time, it remains largely constant compared to that for the poorest, who see their benefits increase drastically from the late 1990s.

This is indeed surprising, particularly given that the political structure in China has remained largely unchanged. Why, therefore, would an authoritarian state compensate the politically powerless in the absence of institutionalized channel of representation? Political stability is an easy answer and it is indeed a critical factor to compel most authoritarian rulers to be careful in mistreating its subjects. Yet, the steady increase of the spending level on the poorest since the late 1990s in contrast to the unimpressive change in pension spending is at odds with the fact that these retired government employees are politically powerful in defending their interests. We cannot assume that this group of individuals would be indifferent seeing their government transfer the money

**Figure 1** Government Spending on Social Protection (% of Government Expenditures), 1978-2014
to their politically inferior counterparts while ignoring their own well-being against market fluctuation and inflation.

Furthermore, as will be discussed in detail later, is that the program is evolving along with a remarkable process of institutionalization – in spite of various problems and shortcomings associated with the program, the institutional foundation has been well established to cover almost the entire population and overcome the urban-rural divide. This poses another question: Why would an authoritarian regime, instead of using cash benefits, make long-term commitment to compensating the poor through institutionalized measures that would apparently tie their own hands?

In revealing the mechanism of institutional origin and change of China’s social assistance program, I attempt to offer a theoretical model that emphasizes the interaction of global and local dynamics, through which the government is induced to utilize institutional instruments to protect the poorest social sectors for its own political survival. Specifically, I argue that economic integration produces an equalization effect on the wage differentials and risk perceptions among different sectors and social groups. As wage and risk gaps get narrowed, the demands for welfare protection across different sectors as well as their ability to exert political pressures on the ruler become increasingly similar, which induce the ruler to listen to the demand of every social sector. I suggest that this is a structural condition introduced by globalization that has produced a world-wide welfare transformation that, as Economist (2012) aptly claims, even turns the East Asian tigers into marsupial.

Precisely because of the authoritarian nature of the regime that tends to offer lip service to the sectors outside of its core constituency, the political elites are particularly motivated to tie their own hands through institutionalizing welfare protection in order to ensure that an effective welfare system can supplement their efforts of building a competitive economy. On the other hand, the enabling effect of economic integration cannot be realized without the suitable local conditions that make political leaders particularly vulnerable and therefore more motivated to expand their political base through institutionalized protection. In short, the genuine commitment to protecting popular sectors through well-functioning institutions must be understood by examining the interaction of global and local dynamics: the regime vulnerability makes a competitive economy critical for a ruler’s political survival; global competition and integration, on the other hand, makes it impossible to ignore any sector in order to survive economic competition.

In the following sections, I will first review the literature of welfare state, and then lay out an endogenous social protection model to explain the welfare-global nexus. A detailed account of the development of China’s social assistance program will be used to test this model. In the conclusion part, I
will discuss the implications of the findings and will particularly reflect on the conventional understanding of the Chinese state and regime survival.

2. Theoretical Debates and Evidence
To understand China’s welfare transition, it is imperative to place China into a broader context of the developing world. Yet, the literature of welfare state is built upon the experiences of western developed countries and faces serious problems of concept traveling. As a result, the theories have tremendous difficulties understanding the dynamics underpinning the welfare transformation in the developing context.

The current literature has been dominated by two opposite hypotheses: the efficiency vs. compensation hypotheses. The former argues that welfare state systems are inherently incompatible with globalization because competition for export markets and for “footloose capital” exerts downward pressure on labour costs, wages, payroll taxes, and import and export taxes, which reduces the basis for traditional social security contributions (e.g. Wildasin, 1988). A great deal of speculation has been derived from this assumption, and ultimately led to the popular “race to the bottom” prophecy that predicts the reduction of welfare protection and the erosion of social agenda as a result of globalization.

The efficiency argument is countered by the compensation hypothesis, which has two variants. The first one is what I call the “power-based compensation” model, which emphasizes the mediating role of electoral institutions between international economic pressures and domestic political outcomes (Garrett, 1998). Influenced by the power resources theory (Esping-Anderson, 1990), this model suggests that the key determinant of welfare expansion is the strength of leftist parties and unions that are critical in ensuring labour-market institutions to be effective in negotiating between government and labour. The second variation of the compensation hypothesis is what I call the “trade-based compensation” model, which sees welfare play an important role of social insurance against the market volatility generated by trade openness. According to this model, higher unemployment and lower real wages during economic downturns force governments to increase welfare expenditures in order to prevent the escalation of discontent over increasing poverty and declining standards of living (Rodrik, 1997, 1998; Cameron, 1978; Ruggie, 1982). The result is a “race to the top” of welfare compensation induced by globalization.

In the context of developing countries, the three models collectively suggest a pessimistic future of welfare development. Whereas the efficiency model attributes the “race to the neoliberal bottom” to the enormous fiscal constraints these countries face (Garrett, 2001; Kaufman and Segura-Ubiergo,
2001) and their lack of the luxury of borrowing on capital markets (Wibbel, 2006), the power-based compensation model believes that the left-labour movement in developing countries is too weak to fight against capitalists, either due to low skill endowments and the high level of labour surplus (Rudra, 2002) or to the underdeveloped democratic institutions, which further aggravate collective action problems among workers (Wibbel and Arce, 2003).

In the trade-based compensation model, the direct link between trade exposure and welfare expansion seems fragile given the serious fiscal constraints in these countries. In addition, as many authors have suggested, this model remains to be a black box in specifying the mechanism linking trade exposure and welfare compensation and therefore fails to explain why many developing countries are unable to provide such institutions even though their trade exposure is strong (Mares, 2005; Adsera and Boix, 2002; Huber and Stephens, 2001; Iversen and Cusack, 2000).

In China’s context, social assistance, as a nascent program, has not yet drawn sufficient academic attention. In a limited number of studies, the focus is instead on explaining what has prevented the system from developing and on identifying the problems and obstacles of the system. The common assumption underpinning these studies is that social assistance programs aiming to help the poor are not compatible with the authoritarian nature of the Chinese state (Zhang, 2010; Leung, 2006). Others emphasize the lack of resources or funding for rural areas that can be the outcome of both fiscal constraints and political bias (Duojicairang, 2001). However, the data in Figure 1 above suggests that China’s welfare development is neither a race to the bottom nor a race to the top. If anything, the government spending on social welfare is nothing but linear. Prior to the late 1990s, the spending on the two categories moves in different directions. Since the late 1990s, while both spending is moving up, the social assistance spending is much faster than the spending on pensions. If the government spending can be taken as an indicator of government’s responses to different social sectors’ demand, the changing distribution of the welfare benefits as shown in the figure is suggestive. Yet the current theoretic models do not seem adequate to offer a convincing explanation.

3. Endogenous Protection Theory and East Asian Welfare Change

3.1. Globalization’s Equalization Effect

In this study, I offer an endogenous protection theory to explain the welfare-globalization nexus. The theory has three components. The first is the equalization effect of economic integration. The starting point is the basic logic of “factor price equalization” theorem in the Heckscher-Ohlin-Samuelson
model (Stolper and Samuelson, 1941; Feenstra, 2003: 31-63), which posits that trade openness helps reduce the price of factors, such as labour and skill endowed in different economies, and therefore changes the industrial structure towards a balanced one among different sectors. In developing countries, since low skilled labour is abundant and the demand for them increases, the industrial structure will change in favour of this sector’s comparative advantage and increases its wages. Since social insurance is meant to compensate those who have the most stakes to lose and are more willing to pay for the premium, the link between skills and risks (Iversen and Soskice, 2001) suggests that trade openness narrows the risk gap among workers with different skills and, as a result, equalizes the demand for welfare protection.

To support this argument, it is useful to cite the studies that discuss how the Chinese public has so far been accepting of the Chinese regime and why strong “push factor” has been missing (e.g. Whyte, 2010; Wright, 2010). As Whyte (2010) demonstrates in his survey data, in spite of the increased inequality, the relatively disadvantaged social groups such as farmers hold most favorable views about China’s change primarily because these groups are much better off than under Mao as the fundamental principle of equity and distributive justice prevails.

At the same time globalization changes the preferences of social groups with regards to state protection, it also induces governments to adjust the welfare system at the supply side. Governments now have fewer incentives to maintain traditional welfare benefits due to fiscal constraints. At the same time, along with the retrenchment pressures on traditional welfare programs, competitive pressures also induce governments to expand social safety net programs such as minimum wage guarantees, social assistance, and health care to the previously marginalized social groups and sectors that have become increasingly critical for improving human capital infrastructure and maintaining a robust economy. In doing so, states are remodelling their role from “welfare state” to “competition state”, in which welfare effort is refocused toward a more Schumpeterian “competitor” or “work-fare” state (Jessop, 1993; Cerney, 1995; Zysman, 1996).

3.2. Endogenous Model of Political Support

The above argument, however, is not straightforward to the existing literature that, in understanding political function of compensation, tends to assume that politicians rely on a fixed coalition to make welfare policies at the expense of other social groups. Underlying this approach is the assumption of labour homogeneity, which sees labour as an anonymous commodity that can be aggregated into a single, undifferentiated factor against capital (Iversen, 2005). In both the power-based compensation model and the efficiency
Globalizing the Chinese Social Assistance Program

model, a zero-sum game plays out between labour unions and capitalists. In the trade-based compensation model, it is exporters and mobile factors against the import-competitors and non-mobile sectors. In reality, however, we often observe that politicians compensate certain social groups, for example, losers of trade openness, who are excluded from their coalition (Pahre, 2008). This puzzle is solved in the endogenous protection literature (Stigler, 1971; Hillman, 1982; Becker, 1983; Grossman and Helpmann, 1994), which suggests that public policies are often the outcomes of politicians’ balancing of contending interests against one another.

More specifically, the endogenous protection model suggests that politicians, in response to global economic pressures, weigh the marginal support between social groups with conflict interests in order to maximize social welfare and political support (Grossman and Helpman, 1994). Politicians compensate social groups only partially, reducing the harm to any one group by spreading it around (Pahre, 2008; also see Hiscox, 2001). The difference between this endogenous political support model and the conventional coalition model can be illustrated in Figure 2, in a simplified style. Assume that a society consists of two major social groups – Left, indicating labour and low-skilled workers, and Right, indicating capital and high-skilled workers. In the coalition model, politicians who seek to maintain their political power look for the most powerful political coalition – either pro-Left or pro-Right – as their political base. As a result, politicians

Figure 2  Political Function of Compensation: Coalition Model vs. Endogenous Model

![Diagram: Coalition Model vs. Endogenous Protection Model](image-url)
will make policies that fully compensate this coalition at the expense of another, which moves the policy outcome further away from the equilibrium compensation point, denoted as C’, where political support can be maximized. In the endogenous protection model, by contrast, politicians compensate partially each social group, but compensate more groups. The outcome is the policy that moves toward the equilibrium compensation policy point C’.

In developing countries’ particular context, the endogenous model becomes particularly salient once these countries have moved away from their previous protective economy to a competitive one. The previously generous yet skewed welfare distribution in favour of a small group of skilled workers in urban formal sectors (Wibbels and Alquist, 2011), which held a strategic position in political coalition for industrialization and political support (Little et al., 1970; Bates, 1982), becomes increasingly unsustainable.

Thanks to this enabling effect, globalization, rather than producing a “race to the bottom,” creates more of a “move to the middle” in which governments pursue a moderate level of spending that nevertheless is inclusive, broad, and balanced in welfare distribution. In many developing contexts, this process can be volatile and may be hindered by various factors. But in a new environment where both economic pressures and the cost of political repression increase, the mechanism of maintaining political support is essentially similar for any regime that faces a shift, or more precisely, an expansion, of the “core constituencies”.

3.3. Local Dynamics of Institutional Change in East Asia and China

The caveat of the arguments developed so far, however, is that they provide a structural explanation of the trend underpinning the welfare transformation across the developing world but are not adequate to explain the variations among countries. Institutional diversity cannot be fully explained by global structural factors, as Steinmo (2010) correctly argues. Why politicians in certain countries are more motivated for this move to the middle and willing to restructure their welfare system than others requires further explanation. After all, a balanced welfare distribution with moderate levels of spending seems to be an elusive task to most governments, which either fight for the status quo and refuse to expand welfare coverage or expand welfare benefits to the point that the economy may get overburdened.

To specify the local dynamics, I resort to the new development in comparative politics. Against the common assumptions that authoritarian regimes have no incentives to build effective institutions, the new studies suggest that institutions, rather than window-dressing, are in fact commonly used by and have played an important role in most authoritarian regimes. The effectiveness of these institutions vary greatly. But scholars have provided
sound theories to explain that institutions matter as much to the authoritarian governance as to a democratic one for a good reason: they provide a mechanism of transparency and commitment for power sharing and serve to co-opt opposition for regime survival (e.g. Svolik, 2012; Boix and Svolik, 2013; Gandhi, 2008; Gandhi and Przeworski 2007; Magaloni 2006). In other words, institutions in non-democratic regimes provide an arena within which incumbents and potential opponents can forge policy compromises.

These findings shed new lights to help move beyond the conventional theories that focus almost exclusively on crisis as the incentive for authoritarian welfare provision. Instead, these findings suggest that more efforts should be put on the understanding of how normal politics operates and works in non-democratic regimes. In this sense, the rigid dichotomy between democracies and a diverse group of non-democracies needs to be played down.

Still, these rational choice-based findings are inadequate to explain specific cases such as East Asian countries that apparently perform much better than most other developing counties, regardless of their regime type, in utilizing institutions to not only survive but also transit. To make the model more historically-informed and geographically sensitive, I go back to the literature of East Asian development and find more cases to strengthen my model of local dynamics.

What is most striking about East Asian societies is not their economic growth miracles but their strong institutions underpinning the growth. In the past, although these societies’ economic growth has been labelled as “inclusive” or “shared” growth (Campos and Root, 1996; Cook, 1996; Kwon, 2009), their previous welfare regimes were often known as “welfare laggard” or “residual welfare state”. In the past few decades, however, these countries have been actively searching for a sustainable and robust welfare system aiming to reinforce the inclusiveness of their economy and they seem, again, capable of doing so. That leaves one to wonder about the local dynamics of welfare transformation in this region and what lessons, if any, these countries can offer to the rest of the developing world.

In explaining these societies’ capacity to respond to global markets using robust policies and institutions, the conventional wisdom tends to emphasize these states’ strong “autonomy” against the resistance from powerful social groups in policy-making and implementation. However, this explanation fails to specify the constraints on elite preferences and therefore fails to explain what makes it difficult for politicians to preserve power through clientelist connections to the private sector and what encourages them to build new institutions for economic transformation.

To address this problem, the literature of elite constraints focuses on the leaders’ strong sense of insecurity from both within and outside of their
national border, which presses politicians to build a broad coalition and emphasize the provision of broad collective goods rather than channelling largesse to key constituencies. Three factors are commonly considered to be important in producing insecurity for political elites: 1) severe external security threats that consume a substantial amount of revenues; 2) over-population, that through mass unrest, demands for a broad coalition; 3) the lack of natural resources for easy cash to buy off popular sectors. The accumulation of this line of literature is the “systemic vulnerability” model developed by Doner and his colleagues’ (Doner et al., 2005). While the previous studies along this line of thinking tend to emphasize these factors in a disjointed manner, Doner et al. (2005) emphasize the simultaneous interplay of three separate constraints which would be powerful enough – making it both a necessary and sufficient condition – for not only the origin of developmental states but also for their capacity of institutional upgrading when the situation requires – such as moving up along the ladder of comparative advantage from labour intensive manufacturing to a value-added one. Missing any of these three factors would render a state “intermediate” (Evans, 1995) at best – Philippines, Thailand, Malaysia, and Indonesia, for example – which may be capable of building institutions for economic development but not of upgrading them when needed.

The logic of “systemic vulnerability” that underpins economic institutional development, I argue, can apply to the welfare institutional development, but requires certain modifications. Powerful in explaining political elites’ motivation for economic growth notwithstanding, the model is static in nature when taking geopolitical factors as the sole explanatory variable for welfare change in these countries, for which, the “move to the middle” is a recent phenomenon. In addition, the model suggests that welfare benefits are nothing more than side payments – in authors’ own language – that serve to buy off the popular sector. If that is indeed the case, welfare institutionalization and the quality of these institutions should not be a major concern for politicians, as long as economic growth generates enough revenues for side payments.

The model, therefore, is disconnected from the global dynamics introduced by economic integration. The remedy, I argue, is to incorporate this model into the endogenous protection model and to allow the global and local dynamics to interact in order to explain national variations. Geopolitical constraints provide exceptionally strong motivations from within to press political leaders to take a hard approach to deal with economic growth by simultaneously dealing with the social issues that affect the sustainability of the economy. Without local dynamics, the external pressures may not be sufficient to reach the full effect. Politicians would be much less likely to make full commitment to institutional upgrading and complementarity when
needed. Global economic integration, on the other hand, adds an additional layer of uncertainty and vulnerability on governments and press them to adjust their policies and institutions constantly, in exactly the same way the systemic vulnerability model specifies. Global dynamics, however, do not simply produce vulnerability. By offering international markets, global integration also gives the governments the opportunities to overcome the vulnerability.

To sum up, East Asian countries’ remarkable institutional development in the past decades cannot be simply the outcome of their geopolitical constraints. It is economic integration that has set up a framework in which peculiar local dynamics in this region exert their influence and made institutional complementarity between economic and welfare ones possible.

The implications of this model are two-fold. First, the revised endogenous model is a dynamic one. It helps explain why East Asian societies were capable of changing their fate after the 1960s but not earlier and why their major institutional upgrading took place in a few particular historical movements, even though their geopolitical features have remained constant. Second, East Asian countries’ experiences, though remarkable, are not exceptional to the rest of the world. Their specific geopolitical features may be particularly inductive to institutional upgrading. The global dynamics, however, are universal and other countries can take advantage of economic integration to find their own path to prosperity in a less ideal geopolitical context. Sporadic successes have occurred throughout the world with or without similar geo-political constraints – Chile, Rwanda, Botswana, to name a few. The recent welfare transformation in many developing countries such as Southeast Asia and Latin America, which have traditionally been labelled as “intermediate states”, suggests that a move to the middle is taking place in a much larger scope today as globalization becomes intensified, even though the pace and magnitude of change varies across countries.

It is under such a backdrop that China’s welfare transformation can be better understood. China shares similar geopolitical dynamics with its East Asian neighbours, even though its national peculiarities certainly produce specific institutional arrangements different from its East Asian neighbours. Yet, again, local peculiarities only exert their influence within the structural environment defined by globalization.

4. Institutionalization of Social Assistance in China

The welfare system in post-Mao China has undergone significant changes in the past decades. That transformation is closely associated with China’s integration into the world economy (Shou, 2013). Welfare restructuring in China has been characterized by both the expansion of traditional welfare benefits – particularly social security and health care – and the creation of the
new social assistance programs for the urban and rural poor. In this study, I will focus on social assistance programs and, through this case, examine the interaction of global and local dynamics that induces welfare institutional change. In what follows, I will break down the process of institutionalization into four phases: 1) from 1993 to 1997; 2) from 1997 to 2003; 3) from 2003 to 2007; 4) since 2007, and will demonstrate that these four phases are closely associated with China’s economic integration.

4.1. 1993-1997: Local Experiments of Urban Social Assistance Reform

Along with more than a decade of economic reforms that successfully transformed the rural economy, China’s urban economic reform remained slow. The key obstacle was the state-owned enterprises (SOEs) that were embedded into the hierarchical state bureaucracy. SOEs functioned as a proxy of welfare state to their employees with generous welfare benefits and rigid labour protection, which seriously hindered the competition of SOEs. The model was proved unsustainable as illustrated by the economic difficulties experienced by the urban residents in the late 1980s, which, in part, fuelled the anger that eventually led to the Tiananmen protest in 1989 and contributed to the clash between reformers and conservative forces in dealing with it. In spite of the cold political climate in the following years, coastal provinces continued to push their door open to foreign trade and investment and their economies continued to boom. The breakthrough came in 1992 after Deng Xiaoping toured Southern China and called for further reform and openness. As a result, the year 1993 witnessed a series of economic reforms. As Figure 3 illustrates, China’s trade openness level increased significantly and steadily after 1992. But the most important feature of China’s openness is its inflow of foreign direct investment (FDI). FDI’s volume jumped from $35 million in 1991 to $110 million, a growth rate of 152%. In 1993, the volume further increased to $275 million, making China the second largest FDI recipient country next to the United States.

Along with the inflow of FDI was the domestic economic restructuring, with the key component being the separation of government functions from enterprise management. To compete with the private sector in attracting FDI, SOEs must end their over-protected labour system and generous welfare benefits. Once the separation of state functions and enterprise management took place and firm managers were given autonomy to hire and fire their employees, the year 1993 quickly witnessed a surge of so-called layoff workers from the urban formal sectors. These individuals kept their formal ties with their firms and might still enjoy certain allowances but their living conditions dramatically deteriorated after the previous welfare benefits were
significantly cut. Urban poverty and instability became a new challenge to the government.

Prior to the reform, China operated a limited relief program (shehui jiuj) for the very poor. The coverage was very narrow, requirements rigid and benefits thin. The program was also characterized by the urban-rural divide. In urban areas, beneficiaries of the program included mainly disabled veterans and those commonly referred to as “three nos” – no working capacity, no stable income, no relatives or supporters. In rural areas, the beneficiaries were “five guaranteed households”, including the aged “three nos”, the disabled and orphans. In 1992, only 190,000 urban people, or 0.06% of the urban population, received a relief fund of 87.4 million yuan, and the per capita benefit was only 38 yuan per month (Leung, 2006), about 25% of the average income per capita in urban areas (Wang, W. 2007: 140). In the rural areas, the number of individuals receiving the fund of “five guaranteed households” in 1993 was three million, 0.35% of rural population (Li and Jiang, 1996: 166).

Most importantly, the relief programs were not institutionalized but instead characterized by arbitrariness and uncertainty. For instance, the benefits were handed out on a temporary basis, often taking place during holidays or when disasters strike. In addition, the management of the relief programs was highly decentralized. Local governments determined the level of benefits and the administrative units that handled the fund were grassroots
governments such as township governments in rural areas and neighbourhood committees in urban areas. The eligibility criteria of beneficiaries were determined to a very large extent by grassroots officials who handed out the fund. The finance of the relief fund was also decentralized, primarily shouldered by local governments or rural collectives.

Since the late 1980s, urban reforms began to produce layoff workers. Restructuring of the social relief program was called for so as to deal with a rapidly growing population under poverty. Because of the decentralized nature of the previous relief program, the pressure was particularly acute for the local governments who were responsible for taking care of this group of individuals. It is, therefore, not surprising that the most economically advanced and open region, Shanghai, took the lead in local experiment. From late 1992, the Shanghai government began discussing the strategy of dealing with the problem of urban poverty. A series of discussions and policies eventually led to the establishment of a minimum subsistence support line for urban residents, effective from June 1993 (Duojicairang, 2001: 98-99). A few months later, another coastal city, Xiaomen, Fujian, took a similar measure. These local initiatives quickly drew attention from the Ministry of Civil Affairs (MCA), which was responsible for the relief program. Concerned about the feasibility of promoting a nationwide program, the ministry took a cautious approach and decided to conduct a pilot program in multiple cities in 1994. By the end of 1996, the minimum living standard guarantee program (MLSG, or *dibao* in Chinese), taking various forms across regions, was established in 90 cities across 21 out of 30 provincial units. At the same time, some provinces also conducted experiments in a rural social assistance program. By 1996, 256 country-level governments have conducted the experiment (Zhang, 2010: 62).

A quick look at the regional distribution of the program suggests that the establishment of the program was determined by two factors: one is economic openness of the cities, and the other the pressures of economic restructuring. Most of the 90 cities that established the program by 1996 are either in the coastal areas where economies were the most advanced and open or in Central and Northeast China which hosted China’s traditional heavy industries. They commonly faced severe pressures of restructuring their traditional heavy industries that had been burdened by redundant workers and they found it impossible to utilize the traditional provisional relief programs to deal with an increasingly larger number of laid-off workers and individuals under poverty the line. Instead, it became critical to establish a new institution to deal with this social problem. By contrast, most of the 9 cities – except Tianjing – that had not established the program by 1996 were from the western region that had a much lower level of exposure to economic integration and therefore the pressure of restructuring (Zhang, 2010: 61).
4.2. 1998-2003: Institutionalization of Urban Social Assistance Program

By 1997, the reform of SOEs that started in 1994 had proved unsuccessful, as a majority of SOEs continued running in the red. In September 1997, the Communist Party in its 15th national congress meeting called for the adjustment and improvement in the ownership structure and explore the multiple forms of public ownership. A comprehensive reform was launched and privatization of SOEs swept the country. The laid-off workers reached a peak of over 6 million in 1997. Urban poverty became increasingly challenging, calling for further reform of social policies. The broader context of this round of reform, however, was the Asian financial crisis that started from June, 1997, a few months prior to the congress meeting. The financial crisis not only added to the hardship on the Chinese economy, as FDI and export volume were reduced, but also fundamentally changed the government’s understanding of its previous development strategies. The government realized that comprehensive reforms must take place across the board and institutional complementarity is necessary for the success. The crisis particularly underscored the need for more institutionalized social assistance policies and programs for people facing the risk of unemployment and poverty. As a result, along with the SOEs, many other areas such as finance, rural economy, and social policies, including social security, public health, and education, were then included in the reform package.

Furthermore, the Asian financial crisis produced additional dynamics on China’s reform at the ideological level. Prior to the crisis, the conservative force ferociously criticized the privatization as a threat to the socialist public ownership. Since 2005, their attacks had gained momentum and created a chilly atmosphere that deterred many local governments from initiating reformist policies. The reformist force launched their own defence in 1997 and was supported by the central leaders, which, overwhelmed by the sense of crisis associated with SOEs, saw no alternatives in dealing with the disaster (Ma, 2008). However, it must be noted that the Asian financial crisis provided the additional dynamics to help the reformists to survive the attacks from the conservatives.

Within this context, the social assistance program was accelerated in 1997. The number of laid-off workers from formal sectors doubled in 1997 compared to the 1995 number. The situation helped the social assistance program to gain further attention. In the annual meeting of the national congress in March 1997, establishing the minimum living standard guarantee program in urban areas became a key component of the 9th five-year plan. Nationwide implementation started. In early September 1997, a few days before the 15th national congress of the Communist Party began, the state council issued a circulation (no. 29) which stipulated that all cities and
counties in the nation establish *dibao* by the end of 1999, which was achieved by September 1999.

The system, however, had obvious flaws. Its decentralized and fragmented nature made the standards of coverage highly uneven across regions and difficult to implement. The lack of financial support from the central government discouraged local governments from implementing the policies. Despite the institution having been set in place, only about one fifth, or fewer, of the individuals under the poverty line were estimated to be actually covered by the program at the end of 1999; the benefit level tended to be too low to help the recipient to make ends meet, and regional disparity was severe (Leung, 2006).

The continued pressures eventually forced the central government to take a more active role in the system. The breakthrough came in September 1999, when the State Council issued “The Regulation of Minimum Living Standard Guarantee System for Urban Residents”, which marked the threshold of institutionalization of China’s social assistance program. The regulation made two significant improvements. First is to standardize the criteria and “cover everyone in need [*yingbao jingbao*].” The second is to increase the transfer from the central government in order to reduce the burden on local governments and provide them with more incentives.

Within four months between the issue of the Regulation and the end of the year of 1999, the central government had transferred 0.4 billion yuan to local governments, which, in turn, also increased their share of the contribution. As a result, the total expenditure of the program reached to 2 billion yuan, increasing by 66.6% from 1998. By the end of 2000, the central government’s transfer doubled to 0.8 billion yuan, and the total expenditure on the program increased by 35% annually. The coverage increased significantly as well. By 2000, the number of recipients was 4 million, compared to 1.84 million in 1998.

Despite the progress, the central government’s financial commitment was still far from sufficient. The financial burdens jeopardized local governments’ incentives to implement the policy. The goal of “covering everyone in need” was still not fulfilled, leaving a significant amount of individuals without assistance. From 2001, the central government strengthened its effort of implementation. First, local governments now were required to set up their regulations and policies. By the end of 2003, all provincial units except Jilin, Shanxi, and Guangxi had set up detailed regulations. Second, the central government drastically increased its financial responsibility, as shown in Figure 4. Compared to the meagre 0.4 and 0.8 billion in 1999 and 2000 respectively, the central government’s subsidies increased to 2.3 billion in 2001, an increase of 187%. Its share in total expenditure increased dramatically too. By 2003, the share of the central government’s subsidies in
the total expenditure exceeded 60%. The increase in the central government’s financial commitment encouraged local governments, particularly the provincial governments, to increase their efforts as well, which significantly reduced the burden that previously was primarily on the lower level of governments, particularly at the county level.

Geographically speaking, the distribution of the subsidies from the central government leaned heavily toward the less developed areas where the need for assistance was the greatest and the financial capacity of local governments was the weakest, including the old rust belt in the northeast and central areas, and the poorer regions in the west. From 2001 to 2003, five coastal provinces including Beijing, Shanghai, Jiangsu, Zhejiang and Guangdong did not receive any subsidies.

Due to both the improved financial situation and pressure from the central government, local governments increased the number of personnel and facilities of the social assistance program at various levels of government. The mechanism of supervision and monitoring was also improved. At a broader level, the concepts of social assistance and of social safety net gained strong attention from media and scholars, producing a positive atmosphere to promote the implementation of the program. Various social organizations, domestic and international alike, began to participate in the effort.
The result is impressive. In 2001, the number of recipients increased drastically to 11.7 million, compared to 2.66 million in 1999 and 4.03 million in 2000. In June 2002, the number further grew to 19.3 million, promoting the Ministry of Civil Affairs to claim that the goal of “covering everyone in need” had been met. By the end of 2002, however, the number was further increased to 20.65 million, and again to 22.5 million by the end of 2003. Since then, the number has remained stable around 22 million.

4.3. 2004-2006: Overcoming the Urban-Rural Divide

The progress, however, was far more significant than the number of recipients and the amount of cash received by the poor. The more significant part of the reform was the comprehensiveness of the reform that, simultaneously, established targeted assistance programs to help the recipients of MLSG in various areas such as employment, housing, health care, education, and transportation. After a number of years of local experiments, the Ministry of Civil Affairs proposed in 2004 an overarching goal of social assistance system by 2010: to establish a nationwide social assistance system with MLSG and disaster relief as the foundation and targeted programs as the supplement. In doing so, however, the challenge would be far greater than establishing dibao alone for it requires not just money but also the concerted efforts of various government branches at various levels as well as the determination of the central government to make it happen. In the next few years, the Ministry of Civil Affairs issued a number of regulations, some of which were co-issued with other ministries such as Finance, Construction, Health, and Labour and Social Security. This suggests that the central government was fully committed to the system.

In addition to the consolidation of urban assistance programs, another significant progress since 2004 is the extension of the social assistance program to rural residents. Until 2004, the development of MLSG in rural areas had been slow, even though between 1993 and 1996, rural dibao enjoyed relatively equal attention from the Ministry of Civil Affairs and many local governments. For example, in a 1996 conference, the Ministry of Civil Affairs proposed to reform the rural relief program and explore the rural MLSG program, and demanded that economically advanced regions conduct pilot programs in order to accumulate experiences. At the local level, many governments began their experiments. By the end of 1997, the number of county-level governments establishing rural dibao reached 997. The most noticeable were Shanghai and Guangdong which established an integrated system of dibao that simultaneously covered rural and urban residents, a practice that was only adapted nationwide a decade later.
From 1998, however, the *dibao* effort in rural areas was halted when the focus was primarily given to the urban *dibao* in response to the surging number of urban laid-off workers. The daunting task distracted much attention and energy from the Ministry of Civil Affairs and the central government. Without the push and financial commitment from above, the local governments ran out of steam. In fact, rural *dibao* was even abandoned in some areas. For instance, between 1999 and 2000, the number of counties in Shangxi that had previously established the program dropped from 87 to 67, with the number of recipients decreasing from 54 thousand to 50 thousand and investment from 11.58 million to 10 million (Wang and Si, 2007). Nationwide, the same declining trend occurred in terms of the number of counties and recipients, even though the investment continued to increase at a moderate level. The sequence of reform seems important in explaining this reverse in rural areas. Once the urban *dibao* was in place and consolidated in 2003, the government began to refocus on rural *dibao* from late 2004.

The challenge in building rural *dibao*, however, was more complicated than the distraction from urban *dibao*. Up to the fall of 2004, the central government insisted that most rural areas did not have the capacity to build *dibao* due to financial difficulties. However, the same concern of financial constraints had always been a focal point in the debate over urban *dibao* throughout the entire process but eventually did not hinder the reform. The sheer size of the rural poor certainly made the government more reluctant to implement the program in rural areas than in the urban areas. But that concern does not explain the enthusiasm of both the Ministry of Civil Affairs and some local governments in experimenting rural *dibao* prior to 1997. The fundamental reason to explain the slow process of institutionalization of rural *dibao* was at the ideational level. The deep-seated bias against agriculture and rural residents underpinned the previous development strategy, which, in the past decades, excluded the rural residents from state protection but instead forced them to be entirely dependent on rural collectives. As the urgency of building rural *dibao* was not great enough for the government to take it seriously prior to 2004, the effort could be easily distracted by urban *dibao*.

The biases against agriculture and rural residents, however, began to change around the early 2000s when rural problems became overwhelming. Along with the decay of rural governance, rural infrastructure was severely outdated and damaged, and social conflicts followed (Shou, 2015; Bernstein and Lu, 2003; Unger, 2002). Income growth in rural areas slowed down in the late 1990s, contributing to the skyrocketing urban-rural income gap. In 2005, the gap for disposable income was 3.22:1, compared to 1.74:1 in 1974, an 85% increase in two decades, according to data published by the national statistics bureau. Along with the rising income gap were a series of problems facing future prosperity: slow urbanization, imbalanced economy heavily
relying on cheap labour and distorted currency, and, ultimately, the associated vulnerability of the economy to the global market. It became apparent that the growth model embraced by the country in the past two decades, which was built upon the sacrifice of agriculture and rural residents, would be unsustainable.

In the midst of a strong sense of crisis and vulnerability, new reforms took place to change the rural tax system, which was responsible for most of the rural unrest in the 1990s. In a decision taken at the Chinese Communist Party (CCP) annual conference in late 1998, “reducing peasant burden” became one of the priorities to deal with. From 2000, the pilot reform was launched in Anhui province. The key component was to simplify the mechanism of rural extraction and convert all the fees, which were often decided arbitrarily by local officials, to taxes so as to improve transparency. In March 2003, the state council decided to make the reform a nationwide effort. However, in early 2004, the government made a surprising announcement to repeal agricultural taxes all together within five years, which was in fact achieved by the end of 2005.

Within this context, a series of pro-agriculture and pro-rural policies were made and eventually accumulated to the “New Countryside Construction” scheme that was formally adapted in the 11th five-year plan during the CCP congress meeting in spring 2005. The key components of the scheme include restructuring agricultural productivity, improving agricultural infrastructure, establishing the New Rural Cooperative Medical System, and universalizing the nine-year compulsory education system and increasing the educational subsidies to poor families.

The rural dibao, naturally, became part of this sweeping package of reform and must be understood within this context. A series of government documents from 2004 indicated an increasing emphasis on rural poverty and a fundamental change in the understanding of rural social assistance within the government. For example, in his state report during the annual national congress meeting in March 2004, Premier Zhu Rongji did not even mention rural dibao, but instead continued to use “social relief” and “five guarantees” to discuss rural poverty. At the end of the year, he stated that rural dibao could be implemented in the coastal areas but the rest of the country should be cautious due to the lack of financial capacity in doing so. In the next year’s annual congress meeting, however, his report encouraged the rural areas to try out the program, which was further strengthened in the Communist Party’s annual congress meeting at the end of the year. A year later, the party congress made a decision, issued in October 2006, stipulating to implement rural dibao nationwide gradually. Two months later, however, the CCP central conference on rural work stipulated to establish rural dibao nationwide from 2007.
At the same time when the central government was contemplating the rural problems, the same ideational change took place in the society as well. The public debate was intensified on the fiscal feasibility of universal *dibao*, with a specific focus on whether to implement it in the rural areas. The underlying concern, certainly, was about the role of the rural sector within the framework of economic restructuring. The debate involved not only the domestic experts but also international organizations such as the Asian Development Bank’s Chinese agency. The nationwide debate during this period helped the central government clarify its understanding of the reform and eventually form a consensus by the end of 2006 (Zhang, 2010; Zheng, 2006; Zheng, 2007).

### 4.4. Since 2007: Building an Universal and Integrated Social Assistance Program

By summer 2007, after the remaining seven provinces joined the program, all provincial units established their rural *dibao*. The number of individuals covered by the program increased by 30% compared to that at the end of 2006 (Zhang, 2010). However, the system remained fragmented due to the criteria used by local governments. Regional disparity and low level of benefits remained an issue. In some less developed regions, the principle of “covering everyone in need” was still not fully fulfilled. In July 2007, the State Council issued a notification that clarified the criteria for coverage and level of benefits, and demanded the provincial governments to increase their financial share. Since then, the focus has been to narrow the gap between urban and rural *dibao* and integrate the two systems into a universal scheme of welfare protection beyond social assistance.

In fall 2007, the CCP in its 17th congress meeting announced a comprehensive and integrated social welfare system, with social security, social assistance, and social relief as the foundation; basic pension, medical care, and *dibao* as key components; charity and private insurance as the supplement. From then on, the official language no longer separates “urban” and “rural” in referring to nationwide social welfare programs. Primary efforts have been given to improving the quality of rural *dibao* in terms of coverage and level of benefits. Assisted by the concerted efforts by the multiple levels of governments in both financial and institutional commitment, progress has been significant in the following years. Figure 1 has shown the significant increase of social assistance expenditure in a broader measure in both rural and urban areas since 2007. Figure 5 further shows the growing trend of *dibao* in urban and rural areas since 2003. The number of recipients of urban *dibao* has been stable since the early 2000s at about 22 million, while rural recipients increased significantly from 2007 and reached a stable level of 53
Figure 5  Recipients (left, 10 thousand) and Expenditures (right, 100 million yuan) of MLSG, 1996-2014

Note: The rural and urban spending since 2013 has been combined into one category.
Source: China Civil Affairs’ Statistical Yearbook, various years.

million after 2010. The expenditures on both rural and urban dibao increased significantly after 2007, and the gap was narrowed. After 2009, the spending on rural areas surpassed that of urban areas.

Although the reform in 2007 laid a solid institutional foundation for China’s social assistance in order to defend its economy against market fluctuation, the system was far from ideal. Studies have shown that the coverage remains incomplete. The benefits remain low. The central government’s financial commitment was not sufficient. The 2008 world financial crisis produced a chilly impact on China’s manufacturing export, which had a strong presence in rural areas. That promoted the central government to further increase its subsidies in rural dibao. In 2009, the central government’s financial commitment for the first time surpassed that of the local government, jumping from the previous year’s 42% of total government subsidies to 63%, helping to further reduce the urban-rural gap.

Along with dibao, targeted social assistance programs such as education and medical care have also been institutionalized and consolidated. To illustrate, Figure 6 shows the increase of medical assistance subsidies which
5. Conclusion: Rethinking the Nature of Chinese Regime

China’s social assistance program has made a significant progress in the past three decades. As demonstrated in the above analyses, two things stand out in this process. First is the extension of the social assistance benefits to the vast majority of the rural poor. The second is the institutionalization of the program that lays a solid foundation for future improvement and for developing other welfare programs. Given the daunting challenge of the urban-rural divide that has constantly troubled China’s reform in the past decades, this progress is particularly impressive.

In an authoritarian regime such as China, this progress does not sound straightforward to understand, for it is against the nature of authoritarianism to extend the benefits to the poor outside of its core coalitions, particularly given that the sheer size of the rural poor in China is intimidating for any authoritarian ruler to handle. Even though it is not uncommon as a strategy for authoritarianism to share economic benefits with the powerless while continually excluding them from power-sharing (Naughton, 2007), buying-off does not sound an accurate description of the dynamics underpinning China’s
social assistance program that is characterized by solid institutions and the government’s commitment to its long-term development.

The process of institutional creation and development described in this study has demonstrated that the process was not a smooth one but instead riddled with constant debates if not outright resistance. The occasional policy retreat, such as that on rural *dibao* from 1997 to 2003, demonstrates that the process can be fragile when a formal channel of representation is lacking for the politically powerless to defend their interests. Precisely because of the fragility of this process and yet the relative success in China’s social assistance program, however, we must provide a sound explanation as to what has prevented the Chinese authoritarian ruler from utilizing the clientelist approach to preserve power and what has instead encouraged it to tie its own hands through solid institutions.

The analysis in this chapter has illustrated that the process of institutionalizing China’s new social assistance system was intimately associated with China’s integration into the world economy. In every critical juncture of China’s economic transition, such as in 1993, 1997, and 2002, the institutional change of the program can be seen as a direct response of the government to the pressures introduced by China’s integration. On the other hand, the response would not have been successful had the politicians lacked strong motivation. Often times, the effort was made not simply by the government itself but also by the entire society as well. Only when the pressures from both the global and domestic levels are strong enough to produce a consensus about the urgency for change, would the politicians be willing to pay attention to what their subjects demand for. Ultimately, it has been the interaction of the competitive pressures from global markets and its vulnerability to its domestic pressures that induced the authoritarian ruler to listen.

Many implications can be derived from this study. A particular concern for this author is the future of the Chinese regime. If this authoritarian regime is capable of listening, how do we compare it to many others and how do we predict its future? Again, my answers to these questions are guided by my understanding of the experiences of East Asian countries in the past decades. One thing that characterizes these countries is their authoritarian origin and legacies. Yet an equally impressive trait of these societies is their shared growth model and broad coalition mechanism underpinning wealth redistribution. Surprisingly, however, it is not common to reconcile these seemingly contradictory traits in the conventional theories of democracy and authoritarianism.

Contrary to common views that authoritarian regimes were built by utterly unconstrained and ungenerous ruling elites, we have found that China’s rulers, as well as its East Asian neighbours during their own authoritarian times, are active in building impressive new institutional capacities for delivering
welfare benefits to popular sectors. The question therefore is to what extent does the East Asian experiences fit in the existing theoretical framework and deserve the label of “authoritarian regime”? Could it be, in fact, a wrong question to ask in the first place whether China’s authoritarian regime can listen? The conventional labelling of China as an authoritarian regime is built upon a profound yet misleading assumption that an authoritarian regime has no incentives to provide public goods, much less through institutionalized channels. Yet, when it comes to public goods provision and normal politics in which elites deal with various social groups, it may not be about regimes *per se* but about elite preferences that determine state capacity and, ultimately, good governance, which is embodied in effective institutions for long-term development.

In this sense, I concur with what Doner *et al.* (2005) have argued: “We should not expect democracy to necessarily yield more capable and more generous states. Nor should we assume that constraints on elite actions are confined to democracies. The values of democracy are undeniable but lay in other places.” In terms of governance and public goods provision, it is determined by something else which China and East Asian countries have well possessed and skilfully exploited.

Then, it comes to the question of regime survival or authoritarian resilience. The answer, in fact, is all about institutional upgrading: to what extent the political elites are capable of developing new institutions in order to keep diverse social interests in balance. That capacity has been the hallmark of East Asian countries well before some of them fully embraced democracy. And it played a critical role in assisting these countries in their democratic transition with much less bloodshed than most other countries have experienced. The more important and meaningful question, therefore, is not how long the Chinese regime can hold its power but in which way it recedes. Does China possess the same capacity of institutional upgrading for a relatively smooth transition as some of its neighbours did? Too much uncertainty at the moment to permit a quick answer. Yet, as far as this study has revealed, there have been quite strong incentives within the Chinese state to seek institutional remedies for the various problems it faces. It is for sure that the threat of revolution and social unrest may not have brought democracy so far. The inclusiveness at times becomes elusive. The imbalance of power distribution within the ruling elites may threaten the effectiveness of institutions (Boix and Svolik, 2013). But a historical perspective does suggest that institutional inclusion plays an extremely critical role in explaining the rise and fall of nations (Olson, 1982; Acemoglu and Robinson, 2001 and 2012) and has had a profound impact on Chinese society in the past decades. And still, the impetus for it remains strong today (e.g. Teets, 2014; Stern, 2013; Lorentzen, 2013;
Chen, 2012; Stern and O’Brien, 2011). That judgment, if holds true, can help predict a, more or less, promising future for China’s transition.

**Acknowledgements**

The author would like to thank Robert Gamer, Robert Pahre, T.J. Cheng, Jessica Teets, the editor and two anonymous referees of IJCS for their comments and help.

**Note**

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Culture and Commerce:  
China’s Soft Power in Thailand

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Abstract
In recent years, China’s soft power has become a matter of much discussion as a crucial component of Chinese foreign policy. In Thailand, Chinese influences are increasingly evident. This can be seen from the large number of Confucius Institutes established in Thailand, the growing number of Chinese tourists visiting Thailand, Thai students studying in China, the inauguration of the China Cultural Centre in Bangkok and the introduction of Chinese media into Thailand. This article examines the growing presence of China on a global scale, with a particular focus on the context of Thailand. It argues that the increasing Chinese influence in Thailand is largely driven by the historical background of Sino-Thai relations, by Thailand’s economic interests as well as by the role of ethnic Chinese communities in Thailand.

Keywords: Soft Power, China, Thailand, Culture, Commerce

1. Introduction
Recent literature shows that the implementation of the Confucius Institute (CI) programme is part of China’s soft power policy and aims to raise the nation’s international profile along with its increasing economic role in the world, despite the controversy about China’s cultural expansion abroad serving its own national interest (Guo, 2008; Lo and Pan, 2014; Leung and Du Cros, 2014; Gil, 2015). Evidently, the CI debate has drawn scholarly and critical attention on how China’s soft power should be perceived.

Developed by Joseph Nye, the term “soft power” describes the ability to shape the preference of others through appeal and attraction. Whereas hard power is exercised through military and economic forces, soft power relies on the attractiveness of a nation’s culture, political values and foreign policies (Nye, 2004: 5, 11). In the case of China, officials and scholars went beyond Nye’s traditional definition of soft power and interpreted...
the concept in their own, broader terms. Kurlantzick (2007: 6) notes that Chinese soft power includes more coercive economic and diplomatic levers such as aid, investment and participation in multilateral organisations. Lai and Lu (2012: 30) broaden the term “soft power” to include multilateral diplomacy, economic diplomacy and “good neighbour” policy. In a speech given to members of the Chinese Communist Party (CCP), former President Hu Jintao and current President Xi Jinping highlighted several methods by which China could exert influence through soft power. The concept of soft power proved highly popular among Chinese leaders, scholars and journalists, as can also be judged from its prevalence in Chinese media (Li, 2008: 287). It therefore played a crucial role in shaping China’s international political strategy.

Despite the significance of this notion in the case of China, the context that either generates or hinders the growth of soft power is understudied. Ferguson (2003) noted that not all non-traditional forces, such as cultural and commercial goods, can influence world affairs. For instance, it does not make sense to say that children all over the Islamic world love the United States just because of American fast food and pop culture. In this sense, Li Mingjiang (2011: 1-18) challenges the received idea about how the resources of power are used: culture, ideology and values can be used for coercion, and military and economic strength can be used for attraction and appeal. In this light, the study of the economic, political, social and cultural context of a host country should be encouraged as a crucial step to better understanding and assessing China’s soft power.

Drawing on empirical data including academic literature, official and media reports, and interviews with the people involved, this article examines the growing presence of China on a global scale, with a particular focus on the context of Thailand – an influential player in Southeast Asia and an ally of the United States – as a case study of Chinese diplomatic practices. The paper also argues that the increasing Chinese influence in Thailand is also driven by the historical background of close Sino-Thai relations, by Thailand’s economic interests as well as by the role of ethnic Chinese communities in Thailand. In other words, the context of Thailand as a host country facilitates the existence and functioning of China’s soft power. To detail the environment that enabled the considerable progress of China’s soft power, this article begins with the historical canvas that shaped Sino-Thai relations. In a second stage, it examines the expansion of China’s soft power due to non-governmental or people-to-people activities (e.g., tourism), and the increasing use of policy tools (such as education and media) for public diplomacy. Finally, it presents a few challenges and expressions of China’s soft power in Thailand, strongly reflecting the role of Chinese governmental organisations and their ties with Thailand’s ethnic Chinese communities.
2. From Alienation to Engagement: the Historical Background of Sino-
Thai Relations

China and Thailand have a long history of close economic and cultural ties. Since the fourteenth century or earlier, there has been evidence of Chinese settlements in Thailand. Traders, artisans and literati played a crucial role in the introduction of Chinese culture to Thai society, including Chinese pottery decoration, and the translation of classical Chinese literature. In the modern era, the tributary system inevitably collapsed and was replaced by modern diplomacy. After the last tribute to China in 1854, there were no formal diplomatic relations between the two countries until the Sino-Siamese Amity Treaty in 1946.

Despite the century-long vacuum of formal diplomatic framework, trade, migration and cultural exchange between the two countries still carried on. Due to its rapid economic development since the mid nineteenth century, Thailand required a considerable number of labourers for commercial trade, production and construction (Suehiro, 1989). This opportunity encouraged massive waves of Chinese immigration to Thailand. Since the late nineteenth century, Chinese immigrants spawned a sizable community and became the largest minority in Thailand. Undeniably, Chinese immigrants in Thailand have become dominant forces that shape Sino-Thai relations, a trend that is widely recognized by both Chinese and Thai officials and epitomized in the expression “China and Thailand are kith and kin” (Zhong tai yi jia qin).

Aware of the potential power and influence that China could exert on the region, Thailand repeatedly tried to avoid establishing diplomatic relations with China. It feared that the Chinese government would interfere in Thailand’s internal affairs due to the huge number of Chinese residents in Thailand who had come to dominate Thailand’s economy, especially during the growing sentiment of Chinese nationalism in the twentieth century (Chinvanno, 1992). After the Second World War, the Thai government finally decided to establish official diplomatic relations with China in January 1946, as the latter’s position on the international stage had become that of a victorious nation.

However, after the establishment of the People’s Republic of China (PRC) in 1949, the Thai government perceived the rise of Communism as a threat to national security. Thus, Thailand became aligned with the US and recognized the Republic of China (ROC) in Taiwan. The US believed that the most powerful weapon to spread communist ideology were overseas Chinese people residing in host countries. Considering the atmosphere of the Cold War and the fear of Communism in Thailand due to the presence of huge Chinese communities, the Thai government strived to control the ethnic Chinese as well as Chinese education and media in Thailand. Under the Phibun regime,
Thailand publicly pursued anti-Communist policies. This led to the massive arrest of many Chinese leaders and newspapermen, while the total number of enrolments in Chinese schools in Thailand decreased considerably, as did the number of schools themselves (Skinner, 1958).

When Sarit Thanarat established the military absolutist regime in Thailand in 1958 after overthrowing the Phibun government in September 1957, the US-Thai relations reached a peak. The years of his dictatorship, as well as that of his associates and successors, can justifiably be called the “American Era” of modern Thai history (Anderson and Mendiones, 1985: 3). A number of other anti-communist policies were also implemented by the Thai military government, with the generous financial and military support of the US. Trade and cultural exchanges with China were interrupted, since the Thai government decided to ban all trading with the PRC along with the import to Thailand of all cinematographic films and publications originating from the PRC.

As international relations stepped into a new phase, US foreign policies dramatically shifted. In 1969, Richard Nixon declared the Vietnamization Policy abandoning Vietnam to its own fate. This policy had tremendous impact on Thailand’s attitude to Communist powers such as the PRC. At first, the Thai government fought against the Communist Party of Thailand, which was backed by the CCP. But given that Thailand and China shared the same concerns on Vietnam’s affairs, Thailand was forced to adapt its foreign policy to that of the PRC. Forced by domestic and international constraints, the Thai government established diplomatic relations with the PRC in 1975 (Chinwanno, 2010).

Since the late 1970s, China and Thailand have forged a close and friendly relationship (Storey, 2011). Especially after the rise of China as a major world power and as the world’s second largest economy, trade and investment in China has received special attention. Cultural and commercial exchanges have also been widely promoted in Thailand. H.R.H. Princess Maha Chakri Sirindhorn has paid numerous visits to China, both officially and privately. The Chinese government sent a pair of giant pandas as a gift of friendship to Thailand.

Normally, Thailand’s foreign policy is to strike a balance between the US and the PRC. However, since the coup d’état in May 2014, Thailand has been ruled by a military junta, drawing widespread international criticism. The Thai junta government predictably leaned towards China in order to obtain Beijing’s recognition of its legitimacy. This dependence has strengthened the alliance between Thailand and China in economic and security matters, especially in those where both authoritarian governments share the same perspectives. Significantly, year 2015 marked the 40th anniversary of Sino-Thai diplomatic relations, which saw the flourishing of closer ties between the two countries in many spheres, including military cooperation.
3. Thai Tourism and the Clash of Cultures

In recent years, tourism industry in Thailand has dramatically changed, and Chinese influence has become increasingly evident. Indeed, tourism is an outstanding part of non-governmental sources of China’s soft power. Tourism is vigorously supported by the Thai government, as it is an important sector of the Thai economy, and the contribution of Chinese tourists to this sector has become increasingly prominent.

Thailand’s reputation as the most popular tourist destination in Southeast Asia for Chinese tourists is largely due to the low-budget Chinese film “Lost in Thailand” (Taijiong), which unexpectedly broke China’s box office record. “Lost in Thailand” tells the adventures of its Chinese protagonists and is set mostly in Chiang Mai – a city in northern Thailand. The film was released in China in mid-December 2012, and was in theatres until mid-January 2013. Unbelievably, it grossed around USD200 million at the Chinese box office, with more than 30 million Chinese viewers within only a month (Zhongguo Wang, 2013).

Thanks to the unprecedented popularity of “Lost in Thailand”, an overwhelmingly larger number of Chinese tourists were motivated to visit Thailand, the top destinations being Bangkok and Chiang Mai, the two locations where the filming takes place (Bloomberg, 2013). Moreover, the expansion of direct flights from many Chinese cities to the main touristic destinations in Thailand has greatly facilitated travelling for Chinese tourists, in addition to the visa-on-arrival facilities, the short travelling distance, and a high value-for-money factor. Therefore, it is not surprising that Thai authorities should speak highly of the Chinese director of this groundbreaking work that has helped boost Thailand’s tourism. Thai Prime Minister Yingluck Shinawatra received Xu Zheng, the director of this film, at the House of Parliament in March 2013.

From a broader perspective, the number of Chinese people travelling abroad has grown tremendously in recent years. Thanks to rising incomes, a less restrictive passport regime and softer spending limits, China is now the world’s largest outbound tourist market (The Economist, 2013). In addition to sightseeing, shopping is the main focus of Chinese outbound trips. According to the United Nations World Tourism Organisation (UNWTO), Chinese tourists have overtaken the US and Germany as the world’s biggest spenders on travel, spending a record USD102 billion on international tourism in 2012, a 40 per cent rise compared to USD73 billion in 2011 (CNN, 2013).

According to the Tourism Authority of Thailand (TAT), Thailand received 22.3 million overseas tourists in 2012. This figure included 2.7 million tourist arrivals from China, accounting for 12.1 per cent of the total. In 2013, the number of Chinese tourists visiting Thailand has reached 4.7 million,
accounting for 17.8 per cent of the total. Due to this impressive 68.8 per cent increase compared to 2012, China has replaced Malaysia as Thailand’s main destination for overseas tourists (TAT, 2014). Since 2013, the number of Chinese tourists visiting Thailand have ranked among the highest, and so was the growth in numbers of Chinese tourists. By October 2015, 6.6 million Chinese tourists had already visited Thailand that year. By the end of 2015, it is estimated that the total number of Chinese tourists will reach 8 million (TAT, 2015).

Undoubtedly, activities and services in Thailand are largely shaped by the preference of Chinese tourists. During Chinese New Year, the TAT launched a series of campaigns targeted at Chinese tourists. With the support of the Ministry of Culture, it promoted “Happy New Year” activities in popular shopping areas in Bangkok. The premises were decorated in Chinese style by hanging red lanterns, Chinese food was sold, and Dragon and Lion dances were performed. In addition, the international airports of Thailand now incorporate more Chinese signs and offer services in Chinese to accommodate Chinese tourists. Moreover, King Power and Naraya – the favourite stores of Chinese tourists – prefer to hire shop assistants who can speak Chinese. Shopkeepers in the Weekend Market now usually speak basic Chinese in addition to English.

Nevertheless, the growing presence of Chinese tourists does not necessarily have a positive impact; it can also cause negative impressions. In spite of the economic advantages, the arrival of Chinese tourists brings “culture shock” to some local residents, especially in Chiang Mai, a large city yet long known for its tranquillity. It is reported that the blockbuster success of “Lost in Thailand” brought a sudden influx of Chinese tourists, whose

Figure 1 Number of Foreign Tourists Visiting Thailand

Source: TAT, 2015.
behaviour caused Chiang Mai residents to complain. While many people working in the tourism industry are delighted by the influx, 80 per cent of 2,200 Chiang Mai residents polled by Chiang Mai University said that they were highly displeased with Chinese behaviour (Chiang Mai CityNews, 2014). The survey and numerous comments on social media blamed Chinese tourists for committing offensive acts, including littering, spitting, queue-jumping, flouting traffic laws when driving, riding bicycles, or parking their cars, and relieving themselves in public areas. Some restaurant owners complained about their Chinese customers filling up doggy bags at buffets.

The rising anti-Chinese sentiments in Chiang Mai can be seen in radical Facebook pages that circulate reports of inappropriate behaviours of Chinese tourists. These pages show that in Chiang Mai University, a travel hotspot for Chinese tourists, known for its beautiful scenery and free entrance, Chinese visitors flooded the premises, disturbed lectures and student activities, and camped overnight on campus. It is reported that Chinese tourists dressed up in the university uniform were arrested for violating university regulations that prohibit non-students from wearing it (Bangkok Post, 2014). In response to the controversial issue of whether Chinese tourists should be allowed on campus, Chiang Mai University decided to capitalise on them by charging visiting fees to reduce the amount of foreigners visiting the institution. Visitors must also take designated tram tours, and are admitted to only certain parts of the university.

Following another sensational report about the inappropriate behaviour of Chinese tourists, the latter were banned from entering Wat Rai Khun, a magnificent white temple located in Chiang Rai, northern Thailand. The report claimed that some Chinese tourists were unable to use toilets appropriately. The ban was ordered by angered temple founder and Thai National Artist Mr. Chalermchai Kositpipat. Half a day later, he cancelled the ban and allowed Chinese tourists into the temple, but on the condition that their tour guides would clean the toilets if Chinese tourists were to make them dirty (Bangkok Post, 2015).

While the misbehaviours of Chinese tourists are widely discussed and deplored in Thai social media, a public intellectual based in Chiang Mai, Nithi Eiwsriwong, noted the passive silence by which local Thais reacted to such scenes. Nithi Eiwsriwong questioned why locals do not immediately intervene and ask Chinese tourists to refrain from offensive acts instead of talking behind their backs. He further explained that Thai people are more likely to opt for gossip rather than face-to-face communications to put pressure on anyone who breaks the social order. This mentality, however, only works within a small community but fails to apply to modern society, especially to temporary visitors. Visitors may leave Thailand before they become aware of gossip, or worse, when gossip turns into radical social pressure that
makes tourists uncomfortable and afraid of ever returning to Thailand again (Eiwsriwong, 2014).

The poor reputation of Chinese tourists abroad has also drawn the attention of Chinese authorities. Chinese Vice Premier Wang Yang criticized the “uncivilized behaviour” of his fellow citizens, and stressed the need for better behaviour when travelling so as to protect China’s image abroad. Also, the China National Tourism Administration (CNTA) issued new guidelines of travel etiquette and international practices for tourists, with helpful illustrations. This move confirms that the policies of the Chinese government aim to improve its people’s capacity to learn from international experiences.


While tourism is merely what could be called the non-governmental or “people-to-people” side of China’s growing presence in Thailand, the Chinese government also attempts to expand its cultural influence across Southeast Asia by using policy tools of its public diplomacy. In this respect, Chinese education is significant, as it is an aspect where Thailand desperately needs assistance from China.

The Chinese government has made a clear and calculated move to develop Chinese education in Thailand. In 2004, representatives from the Chinese and Thai Ministries of Education (MOE) began to discuss the revision of cooperation framework between the two countries. In 2005, the Thai Minister of Education, accompanied by the Permanent Secretary, visited the China National Office for teaching Chinese as a foreign language or Hanban, an institution affiliated to the Chinese MOE. Both parties further negotiated the cooperation framework to promote the learning and teaching of Chinese language in Thailand.

Thailand also recognized the indispensable role of Hanban in the development of Chinese learning and teaching in Thailand. In 2006, the Thai MOE and Hanban signed a cooperation framework for the development of Chinese language teaching and learning in Thai higher education institutions in Bangkok. This framework stated that Hanban would help Thailand develop Chinese curriculum and Chinese language textbooks as well as E-learning materials to be used by Thai schools, and would increase the number of volunteer Chinese teachers sent to Thai schools to 500 a year starting from 2006 (Bureau of International Cooperation, n.d.).

Following the Framework of Cooperation in 2006, China and Thailand concluded an Agreement on Educational Cooperation between the MOE of the two countries in Beijing in 2009. This agreement, witnessed by the Chinese
Premier and the Thai Prime Minister, aimed to enhance the friendly bilateral relations between the two countries in the field of education (OHEC, 2010: 115-118).

Moreover, Thailand’s Office of the Higher Education Commission (OHEC) addressed the need for assistance in the field of Chinese education during the meeting with Hanban in May 2010. It was reported during the meeting that there were 615,270 students learning Chinese in Thailand, including 532,795 students at primary and secondary education levels, 56,365 students at vocational education level, and 26,110 at tertiary education level. The report strongly confirmed the increasing demand for Chinese language learning among Thai students, the problem of the shortage of qualified Chinese language lecturers in Thailand, and the need to develop multi-media for Chinese language teaching and learning made available to a larger number of Thai learners of Chinese language. In this regard, the OHEC considered it was necessary to seek academic cooperation and asked Hanban to send Chinese experts to develop multi-media teaching and learning, testing methods for the evaluation of the linguistic competency of Thai teachers teaching Chinese language, and to provide scholarships and training to Thai teachers of Chinese language through further studies in China or through the participation in short-term training courses (OHEC, 2010: 175-179).

A decade later, it is unsurprising that Thailand is now home to 13 Confucius Institutes (CIs) and 11 Confucius classrooms (CCs), both affiliated to state-run institutions (except for the more recent one, Maritime Silk Road CI). Thailand welcomes more than 8,000 Chinese volunteers, more than any other country in Southeast Asia. The CI project, initiated by Hanban, is introduced as a non-profit educational institution devoted to providing scope for people all over the world to learn Chinese language and culture, and as a platform for cultural exchanges between China and the world (Hanban, 2015a). These objectives are in accordance with the values that the Chinese government claims to stand for in its peaceful rise.

As a Hanban programme, the CIs are established as joint ventures between Chinese partner institutions and local institutions. Thailand’s first CI was established in 2006, receiving its initial operating funds of USD100,000 from Hanban. The local Thai university was responsible for premises, relevant equipment and facilities. Each CI has a joint committee, whose directors come from both countries: one Thai and one Chinese. The Chinese director and instructors, recommended by a Chinese partner university, are appointed and paid by Hanban with two/four-year tenure. Chinese volunteers, though appointed by Hanban, receive no salary but instead are granted a living allowance with one-year tenure on average. Textbooks used in CIs are also imported by Hanban, and are strong conveyors of Chinese culture. Therefore, the funding, personnel and curriculum of the CI are controlled by Hanban.
Nevertheless, host universities also need to self-finance their CI programme in addition to Hanban’s financial support.

In order to apply for annual funding from the Chinese government, CIs need to draw up executable plans for annual projects and budget proposals, summarizing the efficacy reports of annual projects and final financial accounts, and submit them to Hanban for examination and approval (Hanban, 2015b). Although each institute has the freedom to design its own programme, most activities organised by CIs must conform to Hanban’s objectives in order to secure financial support. Therefore, despite

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<tr>
<th>Local Thai University</th>
<th>Chinese Partner University</th>
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<td><strong>Bangkok Metropolis</strong></td>
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<td>Chulalongkorn University</td>
<td>Peking University</td>
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<td>Bansomdej Chaopraya Rajabhat University</td>
<td>Tianjin Normal University</td>
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<td>Suan Dusit Rajabhat University at Suphanburi</td>
<td>Guangxi University</td>
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<tr>
<td>Kasetsart University</td>
<td>Huaqiao University</td>
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<tr>
<td>Maritime Silk Road CI* (located at the premises of Dhurakij Pundit university)</td>
<td>Tianjin Normal University</td>
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<tr>
<td><strong>Eastern Thailand</strong></td>
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<td>Burapha University</td>
<td>Wenzhou Medical College and Wenzhou University</td>
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<td><strong>Northeastern Thailand</strong></td>
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<td>Khon Kaen University</td>
<td>Southwest University (Xinan Daxue)</td>
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<td>Guangxi University for Nationalities (Guangxi Minzu Daxue)</td>
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<td><strong>Northern Thailand</strong></td>
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<td>Mae Fah Luang University</td>
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Note: * Established in 2015.
the large number of CIs in Thailand, their activities, aimed at promoting Chinese language and culture, include, for example, Chinese culture Open House, Chinese music/dancing performances, training courses on Chinese calligraphy, and talks on Chinese language and culture. Unfortunately, research is not a top priority of CIs in Thailand.

Scholarships are part of the CIs’ appeal. Each year, a great number of Thai students apply for scholarships to the China Scholarship Council (CSC) via Thailand’s CIs in order to study in China. According to the 2010–2011 annual report of the Chinese MOE, Thailand ranked fourth among countries sending students to China after Korea, the United States, and Japan (China Association for International Education, 2014). Moreover, the Chinese government awards grants to 200 Thai officials and school principals for classroom observation and cultural visits to China every year.

Thailand is not the only country to receive Chinese assistance in the development of Chinese language learning and teaching. Indeed, this practice is now global. There are currently more than 400 CIs and 600 CCs in over 100 countries. Unlike other cultural organisations subsidised by their governments, such as Britain’s British Council, Germany’s Goethe Institut, and France’s L’Alliance Française, which operate independently and in their own premises, CIs operate within established local institutions, arguably perceived as the reflection of China in overseas education. The role of the CI, especially in the US, has engendered considerable debates among scholars. Marshall Sahlins, an anthropologist at University of Chicago, argues that the mission of CIs involves the promotion of the political influence of the Chinese government, as guided by the propaganda apparatus of the party-state (Sahlins, 2013). According to Sahlins (2014), it is a threat to the principles of academic freedom and integrity that underlie the system of higher education, including the recruitment and control of academic staff, the choice of curriculum, and the freedom of speech. In response to Sahlins’s critique, Edward A. McCord, CI director at George Washington University, denied such claims and contended that the CI, though supported by Hanban, remains independent in operation and management (McCord, 2014). Nevertheless, the American Association of University Professors (AAUP) cites Sahlins’s article and joins the Canadian Association of University Teachers (CAUT) in recommending that universities cease their involvement in CIs unless they can ensure that Hanban will not interfere with core academic values (AAUP, 2014). So far, a few universities have ceased their collaboration with CIs, such as McMaster University in Canada, the University of Lyon in France, University of Chicago in the US, and Stockholm University in Sweden (South China Morning Post, 2015b).

Apart from this controversy, scholarship also addressed the role of CIs in the exertion of soft power in particular countries/regions, showing the
complexities of how CIs were operated and perceived.\textsuperscript{6} In Thailand, the development of CIs is in direct relation to Chinese education in general. First, because of the pro-assimilation policies implemented by the Thai government over several decades, Chinese education in Thailand was completely interrupted and had become defunct in the 1950s (Skinner, 1957). Tejapira (1997) argues that after May 1992, when Thai political culture led to a more pluralistic and democratic society, this new environment gave rise to the “renaissance of Chinese cultural awareness” among the Thai-Chinese population, as many were keen to learn about their ancestors’ language and culture and regained their ethnic consciousness. Publications on Chinese culture became best-sellers, and novels on the life of the ethnic Chinese in Thailand were adapted into popular television series.

In addition to this new cultural awareness, Chinese language learning was also encouraged by the rise of China as a major world power and as the world’s second-largest economy. This phenomenon has encouraged the study of Chinese language, and Chinese speakers are urgently required to meet the increasing demand engendered by trade between China and Thailand. The support to Chinese education received from China through Hanban and the CI programme is therefore timely, and an excellent option for Thailand in the pursuit of Chinese teaching and learning.

Moreover, according to Nguyen (2014), the activities of CIs in the Mekong region play an important role in connecting China and overseas Chinese communities in the region. In Thailand, the growing numbers of CIs are strongly facilitated by the enthusiastic response of the ethnic Chinese communities, one of the largest overseas Chinese communities in Southeast Asia. The fact that the Maritime Silk Road CI – the first of this kind in the world – was launched in Thailand can be attributed to the active role of Chao Khun Thongchai, a reverend abbot from the Buddhist temple of Wat Trai Mit in the heart of Bangkok’s Chinatown. Chao Khun Thongchai is also a well-known patron of the Romchatra Foundation, whose aims are to encourage, develop and promote education in Thailand. According to Dr. Wasana Lertsin, the Foundation Secretary, prior to the Maritime Silk Road CI Chao Khun Thongchai sponsored the establishment of the first global Confucius classroom at Wat Tri Mit School in 2006. A passionate advocate of Chinese education, Chao Khun Tongchai therefore gained public support from both the local community and Hanban (L. Wasana, personal communication, 9 August 2015).

Finally, despite the controversial debates on CIs, the CIs in Thailand remain silent, and still compete with one another for support from the Chinese government. Indeed, academic freedom is not the main concern of Thai scholars, due to the practices of self-censorship that are the legacy of the military dictatorship regime and that have long been rooted in Thai academia.
As long as financial support from China is received, such practices of self-censorship will be pursued for the sake of mutual benefits. Nor are we likely to witness any criticism regarding the issue of academic freedom.

In addition to CIs, China’s soft power initiative to broaden the appeal of Chinese language and culture includes the establishment of the China Cultural Centre (CCC) in Bangkok. The CCC is said to be part of the Chinese Ministry of Culture’s plan for cultural reform and development to strengthen cultural exchanges with people abroad and promote Chinese culture. It is claimed that the CI and the CCC are very different platforms. While the former, established in the host university’s campus, deals with student affairs and focuses on teaching Chinese language, the latter is located in its own venue, hosts more diverse activities, and provide a broader curriculum (South China Morning Post, 2015a).

The establishment of the CCC in Thailand – the first such centre in Southeast Asia – began in mid-December 2007 when the Chinese ambassador to Thailand and the Thai Minister of Culture signed an agreement for the founding of the centre. To celebrate the 35th anniversary of diplomatic ties between China and Thailand, a groundbreaking ceremony for CCC in Bangkok was held in November 2010. Finally, Chinese Premier Wen Jiabao and Thai Prime Minister Yingluck Shinawatra attended the opening of the CCC on 21 November 2012.

The CCC in Bangkok is the world’s largest centre of its kind, located opposite the Chinese embassy. Exhibitions, performances and training courses
on Chinese language, opera, dancing, painting, calligraphy and Taichi are held regularly for anyone interested in Chinese language and traditional culture (Zhongguo Xinwenwang, 2012). The Centre’s annual major event is the celebration of Chinese New Year, which has clearly shown that Beijing perceives the ethnic Chinese worldwide as cultural agents, whose cultural practices can be used to push China’s soft power (Renmin Wang, 2015). Moreover, the ethnic Chinese communities in Thailand are encouraged to participate in cultural activities that engage with contemporary pop culture, such as singing contests and film screening (China Embassy, 2014).

5. A New Force in the Marketplace: Chinese Media in Thailand

In addition to the establishment of CIs and the CCC, the Chinese government has heavily invested in numerous media outlets. Chinese leaders have addressed the importance of enhancing the international outreach of Chinese media to build China’s national image. This effort becomes obvious in Thailand, as can be seen from the launching of the CCP-funded newspaper, the Thai edition of Xinhua news Facebook page, and the improvement of Thai-language China Radio International.

Chinese newspapers have been published in Thailand since the early twentieth century. They initially aimed to provide extensive coverage of commercial and financial news to the business community. However, with overseas Chinese in Thailand becoming actively interested in developments in Mainland China, these papers became a tool to mobilize political movements.
in Thailand about political struggles in China (Skinner, 1957). Therefore, Chinese newspapers became highly politicized, each promoting a particular Chinese nationalist political ideology (Chantavanich, 1997).

In the 1950s, the anti-Communist policy initiated by the Thai government led to the crackdown on pro-CCP newspapers in Thailand. The remaining Chinese newspapers were subjected to self-censorship and maintained their neutral or pro-Kuomintang (KMT) attitudes. News coverage on developments in Mainland China was forbidden. This alienated and forced China to disappear from Thai society. But following the normalization of Sino-Thai relations, the pro-CCP tone has risen dramatically. It is no exaggeration to say that Chinese press in Thailand is directly affected by the relationship between Thailand and China, and complicated by the landscape of world politics.

Today, there are six Chinese dailies in Bangkok including Xingxian Ribao, Yazhou Ribao, Xin Zhongyuan, Jinghua Zhongyuan, Shijie Ribao and Zhonghua. Publishers are reluctant to release figures about their circulation. Most revenues of these papers purportedly come from advertisements and public announcements of Thai-Chinese businessmen who want to be outstanding in Chinese society. Except Shijie Ribao, which is funded by the KMT, other dailies hold neutral or pro-CCP attitudes. In addition to Chinese dailies, there is a Thai-Chinese bilingual magazine titled Student Chinese-Thai Monthly and run by a retired Thai-Chinese professor. This monthly magazine aims to promote Chinese language and culture learning for Thai beginners. So far, Chinese press in Thailand has been heavily self-reliant for matters of fundraising, printing, production and distribution to survive in the marketplace.

In an attempt to enhance its influence, China has seen an opportunity to boost up news coverage on China’s developments and to promote its image internationally in the Thai marketplace. The People’s Daily (Renmin Ribao), the official newspaper of the CCP, officially launched its overseas edition in Thailand in December 2012. More than 300 Thai and Chinese representatives from political, business, cultural and educational circles, as well as Thai and Chinese journalists, attended the inauguration ceremony in Bangkok. The Chinese Ambassador to Thailand, Guan Mu, gave a speech at the ceremony, stating that the People’s Daily (Thailand Edition) is part of Sino-Thai bilateral exchanges and cooperation. This newspaper will be a new window through which Thai people can understand China (Xinhua, 2012).

The People’s Daily (Thailand edition), the first overseas publication of the People’s Daily in Southeast Asia, is a Thai- and Chinese-language monthly magazine, published on the 18th of each month. It is positioned as a high-end magazine targeted at readers in Thai political, business, cultural, and academic circles. The contents are selected articles and photographs from the People’s
Daily overseas edition, as well as related news and reports on Thailand and Southeast Asia.

In addition to the People’s Daily (Thailand edition), Xinhua News Agency, the official press agency of the PRC, has launched its official Facebook page in Thai in 2015. The page provides comprehensive and breaking news for Thai users interested in the Chinese perspective. Obviously, much of the contents are news coverage about China’s developments and accomplishments, such as China’s high-speed train and official visits of Chinese leaders to foreign countries and international organizations.

The inauguration of media operated by the CCP is not a new practice in Thailand. China Radio International (CRI), a Chinese state-run radio station, has been broadcasting in Thai since 10 April 1950. Once critical of the Thai government – an ally of the US at that time – for being against Communist China in the Cold War era, CRI shifted its position in a manner that is consistent with the Chinese government’s new global policy. Thai-language CRI is now committed to “introducing China and the world to the Thai, and promoting understanding and friendship between Chinese and Thai people.” It offers news reports and produces a variety of feature programmes in cooperation with Thai university broadcasting stations at institutions such as Chulalongkorn University, Naresuan University and Mahasarakam University (CRI, 2014). CRI’s overseas office in Bangkok claims that its popularity is such that it receives more than 6,000 letters from listeners each year.

A matter in need of reassessment is the effectiveness of China’s official media policy. The People’s Daily and the CRI are the most representative and authoritative Chinese media to promote China’s image and influence internationally. Their agenda is demonstrably to “propagate” a positive impression about China. However, Thai people can acquire knowledge about China through other channels, such as Thai/Western news agencies and social networks such as Facebook and Twitter, which can reveal different sides of the stories. Recently, serious problems in China – rampant corruption, environmental pollution, natural disasters and food security issues – have been reported in the Thai media and widely discussed in Thai society. More importantly, news coverage from Chinese official media of the disputes between China and other neighbouring countries including Southeast Asian nations makes China appear more aggressive than amicable. Whether China’s official media can challenge the existing media in Thailand and prove effective in creating a better impression of China among Thai people remains to be seen. Nevertheless, it can be said that the burgeoning of official Chinese media in Thailand expresses a shift of Thai attitudes towards China from alienation to acceptance. Since the end of the Cold War in Southeast Asia, and China’s implementation of its “good neighbour” policy in the 1990s, Thailand has become more open to Chinese media, unlike in the early days.
6. Capital Challenge: When old Chinese Meet New China

While the Chinese government expands its cultural influence smoothly, the increased penetration of Chinese capital is meeting resistance. In other words, China’s commercial expansion in Thailand differs from its cultural expansion policies in that Chinese economic forces may face challenges from local capital and media.

Despite being descendants of Chinese immigrants, many Thai-Chinese appear to respond to the PRC capital with some reluctance. The proposed China City Complex in Bangkok, a hub for the export of Chinese commodities, has caused anxiety among Thai small- and medium-sized enterprises (SMEs). Thai SME entrepreneurs, mostly descendants of Chinese immigrants, perceived this Chinese mall as a threat. Its cheaper goods and strong financial support from China would, they feared, hurt small Thai businesses throughout the supply chain from manufacturing to wholesale centres and community shops (Bangkok Post, 2011). Therefore, Thai SME entrepreneurs called for the withdrawal of the project. In addition to Thai SME entrepreneurs, Business and Trade Association proposed to the Thai government a number of measures to protect Thai goods and Thai entrepreneurs. Also, the Thailand-China Business Council warned Thai businessmen to prepare for the incoming capital from China (Bangkok Business, 2014).

In contrast to concerns raised by SME entrepreneurs about the PRC capital, the Thai-Chinese who avidly participate in business/Chinese associations soon mastered how to gain from the rise of China. In early days, business associations included the Thai-Chinese Chamber of Commerce (TCCC) that acted as a central organization that allowed Thai-Chinese businessmen to exchange information, and as a representative to protect their interests when dealing with the Thai government or related authorities. Likewise, Chinese associations including speech-group and regional associations were formed to protect the special occupational interests of their members (Skinner, 1958). More recently, these associations have developed their networks across kinship, speech-group, and regions in a global context. Such a transnational network suggests that these associations function and operate beyond national borders (Liu, 1998). Exclusive interviews of prominent figures in the TCCC mention promoting group visits to China and holding business talks with Chinese entrepreneurs to establish relationships and explore new business opportunities. The TCCC also organizes campaigns to attract younger Chamber members and raise awareness about the significance of the Chinese language, which is an important tool to strengthen business ties with China as well as with other Chinese communities worldwide. This is the current new mission of the TCCC (Taiguo Zhonghua zongshanghui jikan, 2010-11).
Empirically, the relationship between Thailand’s business associations/Chinese associations and the PRC is also marked by the formal acceptance of China’s political values. These associations declare their adherence to the One China Principle and support China’s decision to turn the anti-Japanese war Victory Day (3 September) and the Memorial Day for Nanjing massacre victims (13 December) into new national days (Xinhua, 2014a). Such instances show that these associations are following Beijing’s line for their economic interests in China. Although some Thai-Chinese SME entrepreneurs, who are descendants of Chinese immigrants, may be concerned about the influx of China’s capital, so far there have been no violent anti-China campaigns, protests or riots in Thailand. Perhaps, ethnic Chinese are so successfully integrated into Thai society that Thai people feel less antagonistic toward China, and are therefore able to tolerate Chinese capital. On the other hand, in other Southeast Asian countries such as Vietnam and Indonesia that have border conflicts with China and where ethnic Chinese are less integrated, indigenous people tend to be more sceptical of the expansion of China and capital.

Recently, the Thai junta government has approved the China-Thailand Railway development project. Chinese authorities claim that the railway will help develop transportation infrastructure, create jobs, and improve people’s living standards in Thailand. The project is scheduled to be finished by 2018, and will bring an additional two million Chinese tourists to Thailand every year (China, 2015). However, the project details are not finalised, especially the project’s loan interest rates that were offered to Thailand. This caused several national interest concerns among the Thai population. It was suggested that the Thai government should analyse and evaluate the railway project more carefully to ensure the reliability of China’s high-speed rail technology, and the worthiness of Thailand’s investment (Matichon, 2015). Whether the China-Thailand Railway will become a win-win plan, as China has claimed, remains to be seen.

7. Reflection and Conclusion

This article draws on Thailand as a case study of the practices of China’s soft power, and attempts to examine areas where China has made considerable progress. There are indeed numerous signs of the expansion of China’s soft power in Thailand, such as the growing number of Chinese tourists visiting Thailand, the rapid success of CIs now found in Thailand (despite criticism of the role of the CI in many countries), the increasing number of Thai students studying in China, the inauguration of the China Cultural Centre in Bangkok and the introduction of China’s official media, such as the People’s Daily Thai edition, into Thailand. Empirical evidence demonstrates that in the case
of Thailand, the salient achievement of China’s soft power strongly relies on the policy tools of the Chinese government. Therefore, it can be argued that the notion and practice of Chinese soft power departs from Nye’s original definition, as sources of Chinese soft power mostly are governmental than non-governmental. Moreover, it can be said that the increasing influence of China is largely driven by a historical background of Sino-Thai relations, Thailand’s drastic need to boost economic growth, and the cultural ties with China of ethnic Chinese communities. To conclude, one can argue that China’s ability to appeal abroad depends not only on its own policies, but also on the host country that is the target of China’s soft power.

Acknowledgements
The author is grateful to Professor Liu Hong and Dr. Charlotte Setijadi, Nanyang Technological University, Singapore, for the opportunity to join the panel titled “Beyond Fixed Geographies: Diaspora and alternative conceptions of Southeast Asia”. The author also thanks Tamthai Dilokwittayarat, Pongkwan Sawasdipakdi, Peera Charoenvattananukul, Phakin Nimmannorrowaong, and Kanya Poopak for assistance with methodology, and the anonymous reviewers whose comments greatly improved the manuscript.

Notes
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1. An examination of the Chinese Soft Power Forum (Zhongguo Ruan Shili Luntan), an official platform where Chinese can study and practice soft power, supported by Beijing University, Renming Wang, and the CCP Xinwen Wang, shows that this term is understood in China in a variety of ways.
2. For more details on Hu’s speech, see Xinhua, 2007; and for Xi’s speech, see Xinhua, 2014b.
3. Prior to Sarit’s regime, there was an informal relationship between Thailand and the PRC. Under the leadership of Phibun, the Thai government first strongly supported anti-Chinese policies but later dropped its hostile attitude towards the PRC. This became evident when in 1955 Phibun sent a secret group of official delegates to visit the PRC. One interesting story related to this visit is that Phibun sent the two children of his close friend (Sang Phathanothai) to China to live as the adopted children of Zhou Enlai in order to maintain this secret relationship. One of the two children Sirin Phathanothai wrote a memoir about her life as a child hostage in China in a book titled The Dragon’s Pearl.
4. Chinese tourists usually like to visit universities with beautiful campuses when travelling in China and abroad. It is reported that many prestigious universities
in China and overseas, such as Beijing University, Ewha Womans University in Seoul, and Harvard in Boston are receiving a huge number of Chinese tourists.

5. Generally speaking, a Confucius Institute (Kongzi Xueyuan) is affiliated to a university, while a smaller scale Confucius classroom (Kongzi Ketang) is affiliated to primary or secondary schools.

6. For example, Hartig (2012), using German CIs as a case study, reveals that CIs are connected to the rise of China and are a unique member of the family of national culture institutes. Schmidt (2013) finds that the CI project resonates with Canada’s multicultural project.

7. Arguably, local capital refers to that of the Thai-Chinese who have come to accumulate and consolidate their wealth under the patronage of the Thai ruling class including elites, officials and the military. In the era of Thailand’s economic development during the late 1950s-1970s, they played an important role in the evolution of modern industry under the shadow of the military (Suehiro, 1989).

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China’s Soft Power in Thailand


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Abstract

The rise of non-Western powers, particularly China, is often viewed as undermining international economic governance. This crisis is generally thought to be more severe in informal institutions such as the G20 and the Basel Committee because of their extensive reliance on normative consensus. However, developments after the global financial crisis reveal a different picture. Throughout the process of macroeconomic policy cooperation, G20 deliberations were significantly affected by Germany’s negative attitude. With regard to banking regulations, the US repeatedly delayed the implementation of rules agreed upon by the member states. In both cases, however, Chinese compliance and cooperation were relatively good. To explain this unexpected occurrence, this article offers an analytical framework of normative hierarchy drawn from realist institutionalism and realist constructivism studies. Using this framework, the article illustrates that informal institutions are endowed with a hierarchy in which superordinate Western states supply subordinate states like China with norms and ideas on how to behave and choose policies.

Keywords: Basel Accord, Bretton Woods, financial regulation, institutions, normative hierarchy

1. Introduction

Since the end of the Bretton Woods system, the role of informal institutions in international economic and financial governance has drawn the attention of international relations scholars and political economists (Farrell and Héritier, 2003; Vabulas and Snidal, 2013). In this context, the term informal institutions refers to institutions lacking precise rules that are endowed with law-enforcement powers and rely to a large extent on norms and customs. Groups such as G7/G20, which shape international macroeconomic governance, and the Basel Committee on Banking Supervision are two...
examples of informal institutions. These institutions have achieved moderate success in dealing with the dynamism of the international macroeconomy and finance by virtue of flexibility, which is the major advantage of informal institutions.

Meanwhile, the rise of emerging states – China in particular – has become a considerable concern for advanced states, especially after the global financial crisis of 2008-2009. Because the effectiveness of informal institutions has been supported by shared norms among a small number of advanced states, the emergence of “state capitalist” states like China, which do not share liberal economic norms with advanced states, was expected to have negative effects on the status quo (Bremmer, 2010; Halper, 2010).

However, what has come to pass has differed significantly from that expectation. As we will describe below in detail, although China has been feared as one of the most serious threats to the liberal international order among emerging states, it has consistently exhibited a cooperative attitude since joining the informal institutions. Major advanced states such as the US and Germany, on the other hand, have committed rather deviant behaviours with regard to internationally pursued policy goals.

How can we understand such an unexpected situation? To begin, this article offers an analytical framework focusing on the normative hierarchy involved in informal institutions and then applies it to explain cases of international banking regulations and macroeconomic cooperation. The purpose of the analytical framework is not to create a theory applicable to all behaviours of China in global governance across issue areas. Rather, its purpose is to explain the apparently counterintuitive cases where China exhibited more cooperative behaviours than major Western countries in global governance. In this sense, our approach here is close to a “theoretically guided historical account” (Gourevitch, 1986: 34). Based on this analysis, we draw the understanding that the different degrees of international cooperation between major Western states and China can be recognised as a reflection of normative hierarchy in informal institutions derived from disparity in the power resources held by both sides. Thus, this paper challenges the pervasive view that the rise of China would inevitably undermine cooperation in international economic governance by bringing a different sort of capitalism.

2. Norm Supplier and Norm Demander

Much of the mainstream constructivist literature seems to have some “liberal bias”, in which the diffusion of norms in international society is thought to contribute to the establishment and maintenance of a liberal international order in which international public goods are promoted under relatively equal interstate relations (Adamson, 2005; Epstein, 2012). In contrast, recent realist
constructivism literature tends to focus on the relationship between norm and power or hierarchy. Best (2010), for example, argues that the International Monetary Fund began to adopt a ‘constructivist strategy’ by recommending a policy package that included fiscal transparency, banking supervision, and corporate governance as best practice. It encouraged developing states to voluntarily adopt it. In this context, norms and policy ideas are used as power resources to steer emerging states towards adopting a particular type of economic policy. From the standpoint of an emerging state, pressure for adopting that particular type of policy is quite strong, as the perception deeming that policy sound is diffused through the norms and ideas among financial market participants. The concept of productive power, which asserts that the wide spread of particular knowledge or a perception can lead to the construction of social abilities of actors, is also relevant here. In turn, these can be transformed into power relations among the participants (Barnett and Duvall, 2005; Chwieroth, 2013). For example, categories such as ‘democratic state’ or ‘liberal market economy’ prescribe the positions and abilities of states in the international society.

This line of inquiry highlights that the diffusion of norms separates related actors into two categories: the first is the actor who diffuses norms and policy ideas, and the second is the actor who receives and accepts them. In this article, we call the former the ‘norm supplier’ and the latter the ‘norm demander’. The norm supplier is a state that diffuses norms and policy ideas about international governance issues to other states. The norm demander is a state that accepts norms and policy ideas presented by other states. The relationship between the two kinds of actors tends to be hierarchical in the sense that a norm supplier teaches and guides a norm demander about how to behave and choose policies with regard to international governance issues.

To be a norm supplier, it is a prerequisite for a state to establish its own norms or policy ideas so that they can be applied to a particular international governance issue. The establishment of such norms and ideas usually requires a high standard of economics and other social science research, as well as a rich accumulation of policy experience. In addition to the establishment of a state’s own norms and ideas, the endowment of institutional resources that can be utilised to diffuse the norms and ideas is also important (Bell, 2012). Institutional resources for a state in this regard generally refer to international institutions that tend to support that state’s position. A typical example is the IMF or the World Bank for the US, as the term “Washington Consensus” implies. As will be discussed later, the European Central Bank (ECB) can also be viewed as an institutional resource for Germany. National regulatory institutions with renowned status in global financial markets, such as the US Federal Reserve, can play a similar role. These institutional resources are useful for a norm supplier because they supply various means to diffuse norms
and ideas, such as the remarks and papers of economists or officials. Such resources generally convey a sense of technicality and political neutrality to norms and ideas.

Conversely, a norm demander does not establish its own norms and ideas that can be applied to international governance issues due to an underdevelopment of economic and other related policy knowledge. Accordingly, it tries to acquire legitimacy and technical knowledge about its own behaviours and policy choices by accepting norms and policy ideas presented by a norm supplier or international institution that is heavily influenced by it. Even if a norm demander creates some of its own ideas, they would tend to be interpreted as mere reflections of self-interest and be unlikely to be persuasive due to the lack of institutional resources to support them.

Next, let us consider the problem of how the hierarchical interstate relationship discussed above can be compatible with the stability of informal international institutions. According to Stone (2011), it is inevitable that a state that holds the structural power deviates from the rules in informal governance when these are associated with its vital interests. Structural power in this context refers to the possession of alternative means, such as regionalism, unilateralism, and the coalition of the willing, other than a particular international institution, to pursue policy goals. Yet, for states that lack such alternative means, it is beneficial to keep the powerful state within the institution, thus ensuring the chance to express their voices to it while tolerating its occasional deviant behaviours.

By summarising the above analysis, we can introduce an analytical framework on normative hierarchy in informal international institutions. First, the formation and maintenance of informal international institutions, which rely upon normative consensus, are often accompanied by the process of separating related states into two kinds of actors in accordance with their level of economic and other policy knowledge: norm supplier and norm demander. The relationship between them is hierarchical in that a norm demander in need of legitimacy and technical knowledge about its policy choices is basically cooperative with international institutions, whereas a norm supplier occasionally deviates from the rules formulated by them.

3. International Banking Regulations

The institutional feature of the Basel Committee, the primary institution for international banking regulations, is indisputably informal due to its history, organisation, and regulatory standards (Goodhart, 2011: ch. 14-15). In fact, the origin of the Basel Committee, the G10 finance group itself, was a customary meeting held along with regular meetings of the Bank of International Settlements. Moreover, as the committee itself emphasises
(Basel Committee on Banking Supervision, 2013), its formulated ‘regulations’ are not legally binding, and effectiveness relies solely on their implementation by member states.

Despite such informality, the Basel Accord, mainly known for defining the capital requirements for international banks, has been introduced in more than 100 countries other than committee members and is widely recognised as the global standard of banking regulations. One of the prime factors explaining such voluntary compliance is that many national regulators regard it as technically useful for enhancing the loss-absorption capacity of banks and restraining their risk-taking.

Besides, two kinds of normative factors play crucial roles in promoting compliance. First, the necessity of preventing global systemic risk, the fundamental purpose of the Basel regulations, is widely recognised. In a case where the capital base of international banks in their home countries is undermined, the soundness of their overseas subsidiaries and branches would usually be damaged. Furthermore, due to an increase in the interconnectedness between national financial systems, the international contagion of bank runs has become more devastating in recent decades. In these circumstances, it is highly probable that a failure in banking supervision in one country carries negative externalities internationally. Therefore, many states accept the necessity of adopting global regulatory standards formulated on the basis of advanced regulatory and supervisory experiences.

Second, the norm that a level playing field for international competition should be ensured is also accepted by many states. It is generally easier and less costly for commercial banks to raise money through deposits than through capital markets, since a substantial part of deposits is covered by official deposit insurance, and the habit of depositing is still pervasive among the public, whereas the cost of shareholders’ equity is vulnerable to market fluctuations. As a consequence, if capital requirements are introduced only in a small number of states, the international competitiveness of banks from these states would be significantly lowered. So it is necessary to simultaneously introduce the same level of regulations, at least for major international banks’ home countries.

In addition, market discipline works to some degree to encourage states to adopt capital requirements in a situation where they are intersubjectively shared as an indicator of the soundness of banks by financial market participants. Although, as mentioned above, the Basel regulations are recognised as the global regulatory standard, it is unclear whether they are truly effective in ensuring the soundness of banks, whereby the increase in capital level required by them certainly puts additional costs on banks by restraining bank lending and thereby putting downward pressure on national economic growth.¹ The poor performance of the Basel regulations, evidenced
by their failure to prevent the East Asian and Japanese financial crisis in the 1990s and the recent global financial crisis, also puts their effectiveness into question. Nevertheless, once the perception that banks not satisfying the Basel requirements are unsound spreads among participants of stock and interbank markets, and the situation of the spread of the perception is recognised, those banks will probably be unable to raise money. Thus, shared perception influences the behaviour of market actors in a self-fulfilling way, so that states are pressed to comply with the requirements despite uncertainty concerning their effectiveness (MacKenzie, 2008).

In 2009 the membership of the Basel Committee expanded from 13, the majority of which were G10 members, to 27, covering all members of G20. How did this expansion of membership change the effectiveness of international regulations? One concern was that the participation of emerging states – particularly ones like China, which pursues state capitalism in which the financial system is mostly dominated by state-owned banks – would undermine the normative consensus among member states, which was established in the period when the committee was a club-like forum of liberal advanced states.

However, the real situation differs significantly. The Basel Accord has undergone major revisions twice since the introduction of its original version, Basel I, in 1988. In Basel II, which was agreed to in 2004, the risk management models of large US banks were explicitly introduced into regulatory measures on the initiative of the Federal Reserve. However, while the EU and Japan started to implement Basel II in accordance with the schedule agreed to by the committee, the US unilaterally determined one year’s delay of the implementation after demonstrating some confusion (e.g. announcing the Basel IA modification) and in the end failed to fully implement it due to the outbreak of the global financial crisis (Tarullo, 2008).

A similar tendency has been observed regarding Basel III. Basel III, which requires banks to meet a higher core capital ratio than the previous versions, was formulated mainly on the initiative of the US and Great Britain. Nevertheless, the US again unilaterally announced the delay of the implementation of Basel III in November 2011 and began to implement it one year later than the internationally agreed-upon schedule. The delay of implementation increased the probability of international systemic risk and might have reduced the overall compliance level by giving other states the incentive to follow suit or take countermeasures. Indeed, in response to the US’s delay, the European Banking Federation requested Michel Barnier, EU commissioner for financial regulation, to postpone the enforcement of CRD IV and CRR I (the European version of Basel III) by one year (Euroweek, 30 November 2012). At the European Banking Congress in Frankfurt, Sabine Lautenschläger, vice president of the German Bundesbank, suggested

Compared to the US, China has demonstrated high loyalty to the Basel regulations. China began to introduce the Basel regulations into its domestic regulations long before its participation in the committee. Since its participation in the Basel Committee in 2009, the China Banking Regulatory Commission (CBRC) and the People’s Bank of China have promoted the rapid introduction of Basel II and III. Under an original plan announced in May 2011, CBRC set a higher core capital ratio than Basel III and planned to start the implementation process and finish its full implementation earlier than the internationally agreed-upon schedule (CBRC, 2011). Even when faced with the announcement of the US’s delay in November 2012, the vice chairman of CBRC, Wang Zhaoxing, emphasised CBRC’s loyalty to the Basel regulations by stating: “The US decision will never have an impact on China’s policy to implement the rules as originally planned. China will continue to participate in the reform of the international financial system as a member of the international financial society” (Shanghai Zhengquan Bao, 21 November 2012). However, the US’s delay might make Chinese banks less competitive internationally.

3.1. Difference between China and the US

How can we understand these contrastive behaviours of China and the US? A background factor of China’s positive attitude towards the Basel regulations is the legacy of planned economy, namely the unclear demarcation between public finance and commercial bank lending. Chinese commercial banks have historically been forced to finance investment projects that lack profitability by local governments and state-owned firms that have pursued rapid growth even under tight fiscal constraints (Shih, 2008). As a result, the Chinese economy tends to suffer from serious problems of bad credit and inefficiency of the overall national economy. In order to improve such a situation and enable banks to acquire the capacity of intermediating money from savers to corporate investments on a commercial basis, it is vital to establish a risk-management and corporate-governance system. The Basel regulations are regarded as an essential measure for this reform.

On the other hand, the Basel regulations are also associated with certain drawbacks, which are well recognised among political economic actors
in China. For example, an ex-vice chairman of CBRC, Tang Shuangning, requested his successors to introduce Basel III more slowly and cautiously when they planned to finish implementation before the internationally agreed-upon deadline (*Diyicaijing Ribao*, 23 March 2012). The steep fall of share prices of commercial banks in response to CBRC’s announcement to introduce Basel III implied that market participants expected the introduction to constrain the profitability of commercial banks. *Huanqiu* magazine carried an article that even argued, with reference to a widespread suspicion that the objective of the previous Basel regulations was to weaken Japanese banks, that Basel III was a Western conspiracy to slow down the growth of Chinese banks (*Huanqiu Caijing*, 21 February 2012). Ba Shusong, vice director-general of the Research Institute of Finance of the Development Research Centre of the State Council, criticised Basel III by stating, ‘the West got sick and the East took the medicine’, meaning that several new rules, such as counter-cyclical buffers that were mainly designed to tackle the problems of Western banks, would probably generate harmful effects on developing economies whose reliance on bank lending was much greater (Ba, 2012).

When the US postponement of Basel III was announced, Zhu Guangyao, vice minister of finance, indicated that China should also be cautious about the consequence of the new regulation, because lending to small and medium businesses could be restrained in China, as was pointed out in the US. The consequence of the reduction of bank lending on economic growth may be especially severe for states like China, where a large portion of financial intermediation is undertaken by commercial banks. Xiang Songzuo, chief economist of the Agricultural Bank of China, also maintained that it was not necessary for China to rapidly introduce Basel III, given that previous versions of the Basel Accord failed to prevent the major financial crises and banks’ excessive risk-taking (cited in *Yingcai*, 6 February 2013).

Based on these observations, it is unlikely that China simply believed it would acquire the ability to prevent systemic crises and improve bank management just by adopting the Basel regulations. Hence, in order to explain China’s extremely positive attitude, we should take legitimacy concerns into consideration. First, the high legitimacy of the Basel regulations was helpful for domestic reform of the financial system. Capital requirements that encourage more prudent lending could conflict with the interests of state-owned firms and local governments in need of lending. Needless to say, the burden of additional capital requirements for banks themselves is also heavy. In such a situation, the legitimacy that international agreements entail can be used as external pressure by the financial authority to overcome the potential resistance against the regulatory enforcement. Second, compliant behaviours of banks to the Basel regulations are generally perceived as legitimate in global financial markets and hence make external market access easier.
Therefore, the intersubjective perceptions of Basel capital adequacy standards as a benchmark of sound banking among financial market participants press states to voluntarily adopt them. It is significant in being acknowledged as having a sound banking system, especially for states like China, which are beginning to pursue foreign operations expansion.

The positive attitude of the financial authority towards international regulations was shared by those that would also be regulated by it: the commercial banks. For instance, when the Bank of China was selected as a global systemically important bank (G-SIB) on which additional capital requirement would be set by the Financial Stability Board (FSB), a manager of the bank was reported to have expressed his feelings as ‘half pleasure, half anxiety’ (cited in 21 Shiji Jingji Baodaos, 8 November 2011: 9). A financial analyst in another Chinese bank congratulated the selection, interpreting it as proof that a Chinese bank had entered the world-premier league of finance. This positive attitude of Chinese banks towards regulatory enforcement was highly contrastive with that of US banks (Financial Times, 12 September 2012: 1). As such, it is evident that China demands the policy ideas embodied in the Basel regulations in order to proceed with domestic financial reform and acquire better acknowledgement in global financial markets.

The US’s behaviours differed significantly from those of China. Its poor performance in the implementation phase, despite its leading role in the rule-making process, seems hardly understandable. The case of Basel II was particularly notable, as the revision of the original Basel I was actively promoted by the US Federal Reserve, which at the time was facing intensive demands from US-based bankers’ associations, such as the Institute of International Finance and the American Bankers Association. The direct factor behind this paradoxical situation was supposed to be the fragmentation of the US domestic regulatory system, in which three federal regulatory agencies – the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) – coexist and independently supervise domestic banks with different policy purposes. This regulatory fragmentation reflects the fragmentation of the financial system itself, which consists of thousands of small local banks. It tends to be extremely difficult to reach a compromise about appropriate and fair levels of regulations in a situation in which each regulator promotes each priority that reflects its clients’ considerations (Garten, 2001).

In addition, a more fundamental reason why the US can give priority to domestic policy adjustments is that it is a supplier of the policy idea that constitutes the basis of the Basel regulations. Indeed, the core framework of the Basel regulations drew largely upon US regulatory and supervisory experiences. For example, US regulators experimented with risk-weighting approaches as early as the 1950s (Quillin, 2008: 180). Thus, as a consequence
of being in a position to provide technical knowledge for international institutions, the necessity of sticking to the Basel regulations in order to help US banks acquire acknowledgement in global financial markets is relatively low. To put it differently, as far as the US is concerned, the adoption of the Basel regulations is not indispensable for the improvement of its regulatory and supervisory capability, since US domestic institutions such as the Federal Reserve were originally endowed with regulatory measures of the Basel regulations. Rather, most advanced measures and know-how in the field of financial regulations are derived from US experience of regulating and supervising the world’s largest financial market, and this situation was well recognised in global financial markets in which US-based financial institutions and investors are the most influential players. In short, the US has alternative means (i.e. regulation and supervision by domestic institutions) to make market participants confident in the soundness of US banks. Hence, faithful implementation of the Basel regulations is not necessary to create this perception.

Conversely, China, as a norm demander, needed the legitimacy and technical knowledge involved in international regulations settled by authoritative institutions such as the Basel Committee and the US Federal Reserve. Therefore, it had few options but to follow the Basel regulations in order to acquire credibility and legitimacy among financial market participants, even in a situation in which the competitiveness of its commercial banks could be disadvantaged by a more radical tightening of regulations than the international agreement or by the deviance from proper implementation by a norm supplier state.

4. International Macroeconomic Cooperation

Since the end of the Bretton Woods era, G groups have become the main forums for macroeconomic cooperation of finance ministers and central bank governors, or the heads of major states. Among them, the G20, of which membership includes both advanced and emerging states, was established at the finance minister and central bank governor level after the Asian financial crisis. It began to attract significant attention from major states after the summit-level conference was first held in Washington, D.C., in 2008 in response to the deepening global financial crisis. Then the G20 designated itself as the premier forum for international economic cooperation in the statement of the G20 Pittsburgh Summit held in September 2009 (G20, 2009).

The key institutional characteristic of G groups is informality, in the sense that they lack formal rules of membership, the formal authority to make rules, and the formal processes for decision-making (Baker, 2006; Woods, 2010). This informality has been consciously pursued and maintained in order to
facilitate free and relaxed discussion and confidence-building by leaders, ministers, and governors of member states. To compensate for the lack of formality, the consensus of norms and policy ideas play important roles.

With respect to macroeconomic policy cooperation dealing with the global financial crisis, the most crucial normative factor that supports effective cooperation is the revival of Keynesianism. Although economic thinking and policymaking had been dominated by neoliberalism in previous decades, the global financial crisis generated renewed interest in the insight of John Maynard Keynes and Hyman Minsky about the essential instability of financial markets and made the ideas of so-called new Keynesians, such as Paul Krugman, Joseph Stiglitz, and the then IMF chief economist Oliver Blanchard, more influential (Skidelsky, 2010).

Furthermore, international cooperation with Keynesian stimulus policies that were originally designed as remedies for domestic recession was supported by the norm that the nightmare of the interwar period must be avoided. Based on the historical experience of the 1930s, such as the spread of beggar-thy-neighbour policy and block economies, it was probable that the international economy would face a zero-sum game in severe recession phases like the period after the recent financial crisis. This means that if a state unilaterally creates demand by spending fiscal expenditures, other states might free-ride on the demand by increasing exports to that state. To overcome such a problem through collective action, it is essential to ensure international policy cooperation (Stiglitz, 2010: ch. 8).

In such a normative atmosphere, the IMF managing director Dominique Strauss-Kahn, who described the world economic situation as a “Keynesian recession”, proposed a global fiscal programme amounting to be 2% of the world GDP in November 2008. In addition, the UK government announced a fiscal measures package of 20 billion pounds (Farrell and Quiggin, 2012: 20-23). Lawrence Summers, senior economic advisor to US president Barack Obama, said in an interview that the macroeconomic focus of the G20 should be on global demand (Financial Times, 9 March 2009: 1). Thus, the IMF and Anglo-American policymakers who had been chief advocates of neoliberalism unanimously turned to Keynesianism after the global financial crisis.

The G20 London Summit in April 2009 arguably marked the peak of international macroeconomic cooperation. The most significant achievement of the conference was that the concerted application of expansionary policies was confirmed in the leaders’ statement. Actual numerical targets to be achieved by the end of the next year, such as the amount of fiscal expansion and output growth, were also written down in the statement. This agreement was largely in accordance with a request from the US, which regarded its huge current account deficit as evidence of other states’ free-riding on American demand.
In this situation, Germany concentrated its efforts on not bearing an additional obligation of fiscal expansion exceeding its predetermined amount, although it announced a series of stimulus packages, partly because it was required to do so in the EU. Chancellor Angela Merkel openly rejected the extra stimulus packages advocated by British premier Gordon Brown at the stage of preparing a common position of EU member states at the Summit (The Guardian, 20 March 2009: 1). German finance minister Peer Steinbrück was also reported to have described the failure of US efforts to reach agreement for an additional round of fiscal stimulus in the summit as “very beneficial” (EIU ViewsWire, 2 April 2009) from the beginning of the process of international policy cooperation. Above all, China announced a four trillion yuan (approximately 586 billion dollars) stimulus package, an amount equal to 12.5% of China’s then GDP, about a week before the G20 Washington Summit. One day before the G20 finance ministers and central bank governors’ meeting in London, Chinese premier Wen Jiabao declared that China could undertake additional measures for boosting economic growth at any time (Xinhua Wang, 14 March 2009).

The difference in the attitudes of Germany and China became increasingly more pronounced. At the G20 Pittsburgh Summit in September 2009, the United States pursued a strategy to shift the responsibility of playing the role of the “locomotive” of world economic growth to surplus states, particularly China and Germany. The IMF’s Blanchard endorsed this US position by indicating the necessity of a shift in the pattern of global demand away from the US (Financial Times, 21 September 2009: 9). Gordon Brown also advanced a plan for a “global compact” for coordinated stimulus policies by major economies (Wall Street Journal, 22 September 2009: 2). Contrary to US and UK positions, Germany insisted that a coordinated exit strategy from expansionary stimulus packages should be launched as soon as possible, because excessive expansionary policies would lead to inflation.

Despite facing similar pressure as Germany as a surplus state to share the responsibility for stimulating the economy, China did not follow the German path. Instead, it largely stayed loyal to the norm of Keynesian policy cooperation. At the Pittsburgh Summit, Chinese President Hu Jintao emphasised the importance of economic growth and insisted on the continuation of concerted stimulus policies and active utilisation of the G20 meetings. He also alluded to an intention to accept the adjustment of the export-led growth model in his remarks on the necessity for more balanced world economic development in terms of saving–investment balance and international trade.3 This Chinese stance cannot be seen only in terms of China’s concerns for its domestic economy, given that anxieties over inflow of hot money and the investment bubble were rising, and the necessity of an exit strategy already began to be discussed among Chinese policymakers.
Following the contradiction between the US and Germany, the summit’s statement revealed ambivalence about an exit strategy and the responsibility of policy adjustments for redressing global imbalances.

In the G20 Toronto Summit of June 2010, it became obvious that major states had begun to prioritise their domestic or regional concerns. The persuasiveness of the German argument that austerity should be prioritised over economic growth was enhanced by the evolution of the euro debt crisis. The US pursued concerted expansionary policies, as always, and warned Germany about the risk of a premature adoption of exit strategy. In response, Germany’s finance minister Wolfgang Schäuble claimed that excessive fiscal deficit and high inflation could bring more severe consequences than the decline of economic growth (Farrell and Quiggin, 2012: 41). Regardless of the US stance, European states were pressed to adopt Germany’s push for austerity measures in a situation where the spread between German and other Eurozone governments’ bonds came to be recognised as their sovereign risks in global financial markets. In Britain as well, in contrast to his predecessor Brown who sought to take the international initiative of crisis management, David Cameron, whose Conservative-led coalition took over in 2010, emphasised the risk of becoming another Greece and turned to fiscal consolidation.

Given these unfavourable circumstances, the US was forced to choose a compromise and tolerate the declaration of the summit emphasising the importance of austerity rather than economic growth. For example, the declaration clearly states the commitment by advanced states to halve deficits by 2013 and reduce government debt/GDP ratios by 2016, although it also mentions the continuation of fiscal stimulus. This shows that the Toronto Summit was the turning point that put an end to the phase of Keynesian policy cooperation (Farrell and Quiggin, 2012: 40-43; Blyth, 2013a: 59-62).

While the disagreement in the West became obvious, China consistently remained loyal to the norm of US-led Keynesian cooperation. At the G20 finance ministers’ meeting in Busan, which was held in the same month as the Toronto Summit, Chinese finance minister Xie Xuren argued for the continuation of active fiscal policies and moderate monetary easing, and he declared the promotion of expanding domestic demand and the transformation of the economic growth model that had contributed to the accumulation of the current account surplus (Xinhua Wang, 5 June 2010). Additionally, just prior to the Toronto Summit, China announced the decision to increase the flexibility of its exchange rate, which had been fixed since the outbreak of the global financial crisis. These behaviours can be interpreted as signalling the intention to avoid becoming targets of US pressure along with Germany as a surplus state.4
4.1. Difference between China and Germany

How can we understand the different attitudes between China and Germany? It is certainly the case that China’s active involvement in concerted expansionary policies was motivated by a desire to recover its domestic economy. For China, which had sought export-led growth for decades, cooperative efforts to boost world economic growth were undoubtedly beneficial. Nevertheless, China’s behaviours cannot be fully captured in terms of material gains.

As mentioned above, international cooperation on macroeconomic policies has some aspects of collective action. Under the situation in which major states are affected by severe public debts, as has recently occurred, it is more likely that states have the incentive to free-ride on other states’ fiscal expenditures. Further, it should be noted that states often try to transfer adjustment costs to one another in macroeconomic cooperation, because if states adjust their macroeconomic policies for international policy goals, the original domestic goal has to be at least partly sacrificed (Cohen 2006: 31-50). In these circumstances, surplus states in particular tend to receive foreign pressure to expand domestic demands for pulling the world economy out of recession, as they are seen to have the financial capacity to do so even during crisis periods. Japan, which suffered from the bubble economy and subsequent ‘lost decades’ from the 1990s onwards after faithfully following the logic of G5/G7 policy cooperation, is widely perceived as a typical example of having excessive adjustment costs imposed upon it. The Chinese media often warns their government not to make the same “mistake”. With this distributional aspect of international policy cooperation being taken into consideration, it is plausible to argue that China should have acted more purely for its own economic self-interests, prioritising the minimisation of adjustment costs by carefully preventing overinvestment and the accumulation of public debts.

However, it is now evident that the amount of China’s stimulus package far surpassed the optimum level for its domestic economy. As a result, a huge amount of money poured into local government financing vehicles and property developers, and harmful effects, such as property bubbles and excessive production capacity, have become glaringly obvious. A former minister of industry and information technology, Li Yizhong, pointed to the negative consequences of the stimulus package and claimed that it was necessary to draw lessons from their inexperienced crisis management (Huanqiu Wang, 7 March 2013).

To explain these behaviours, it needs to be understood that China was a norm demander in the issue of macroeconomic policy cooperation due to its relatively limited experiences in modern macroeconomic management. Throughout the process of international policy cooperation after the Lehman Brothers collapse, China seems to have attached considerable importance
to acknowledgement from the West and Western-led institutions. In fact, China tended to announce policy plans just prior to important international conferences, and thereby succeeded in being praised. In particular, China’s announcement of a macroeconomic stimulus plan before the G20 Washington Summit was applauded by important figures in international policy circles, including IMF’s Strauss-Kahn and US Secretary of State Hillary Clinton. In February 2009, the G7 finance group at Rome also stated: “We welcome China’s fiscal measures and continued commitment to move to a more flexible exchange rate, which should lead to continued appreciation of the renminbi in effective terms”. The fact that these praises were intensively covered by state-owned media points to China’s high sensitivity to international reputation concerning its macroeconomic contribution (see, for example, China Daily, 25 June 2010). Moreover, China, though unintentionally, contributed to the correction of global imbalance by reducing its current account surplus by half since the global financial crisis.

These Chinese attempts to seek acknowledgement demonstrate that China accepted the norm of Keynesian policy cooperation. Therefore, it is not surprising that China occasionally went to the extent of threatening the stability of domestic economy in part due to its desire for international acknowledgement and self-acknowledgement about the conformity of its behaviour to the international norm. Indeed, such a perspective is also shared by Chinese actors. For example, a senior research fellow of the Chinese Academy of Social Sciences, Wang Tongsan, argued China’s behaviours that received intensive international applause, namely the stimulus package for tackling the global financial crisis and the avoidance of devaluation during the Asian financial crisis, in the end turned into losses for China (Shehui Kexue Bao 1369, 2013: 1).

Chinese Premier Li Keqiang mentioned at the Summer Davos Forum in 2013 that China would contribute to the world economy with a stable growth rate and that the responsibility that China would take for the world economy should conform to the development level of the Chinese economy. At the G20 finance group meeting in Sydney in 2014, Chinese finance minister Lou Jiwei also claimed that the current rate of China’s contribution to world economic growth, around 30%, was already significantly higher than the share of the Chinese economy in world output, and it was impossible that the rate would reach 50% as it had during the period of the global financial crisis (Renmin Ribao, Overseas Edition, 26 February 2014: 2). These remarks seem to reflect the perception that China lost sight of domestic priorities by being inclined towards international acknowledgement during the period of global financial crisis.

In contrast, Germany has consistently prioritised its domestic policy goal. The fact that Germany was reluctant to participate in macroeconomic
cooperation, and often requested exit from it, seems to affirm its indifference to international acknowledgement based on the norm of Keynesian policy cooperation. When asked about the leadership in international policy cooperation that other European states expected Germany to exercise, Steinbrück expressed scepticism about the benefits of doing so (Newsweek, 152[24], 2008: 23). The continuous expansion of Germany’s current account surplus may partly reflect its lack of intention to transform the economic growth model into a domestic demand-led one in accordance with the logic of international macroeconomic cooperation.

Why was Germany – unlike China, which faced similar pressure as a surplus state – relatively free from international normative constraints? The reason is mainly attributed to the fact that Germany was not a norm demander in the issue of macroeconomic cooperation. In other words, Germany had already established its own norms in making macroeconomic policy choices and therefore did not need to learn from international institutions. Germany’s principled macroeconomic-policy norm is that anti-inflation should be prioritised over any other macroeconomic goal, including economic growth and employment. As is well known, this extreme conservatism derives from the historical experience of hyperinflation in the 1920s. Additionally, Germany’s export-led growth model has some anti-Keynesian elements in that it needs in order to constrain the increase of prices and wages for export competitiveness (Blyth, 2013b: 48-49).

Ordoliberalism, a German variant of neoliberalism, which has been influential in German economic thinking, also deserves attention. Ordoliberalism takes seriously the role of the state and institutions in maintaining the order of the competitive market, although it is a liberal thought in terms of its fundamental reliance on market mechanism. In this respect, ordoliberalism departs significantly from laissez-faire liberalism. Notable ordoliberals such as Walter Eucken and Franz Böhm assume that a free market is vulnerable to rent-seeking activities and has a natural tendency towards inflation and market concentration. Therefore, the role of public institutions, particularly independent central banks and competition authorities, is essential for protection against these harmful effects (Sally, 1998: Part III; Bonefeld, 2012; Blyth, 2013a: ch. 5. See also, Foucault, 1997).

It is obvious that these economic beliefs are incompatible with Keynesianism, the core norm of international macroeconomic cooperation, since its essence is to artificially generate inflation to get out of recession rather than contain it. Owing to its established norms, Germany was able to refute or ignore international pressure to adopt policies that were incompatible with its own norms. Moreover, Germany can play the role of norm supplier for European states on the condition that its arguments are endorsed by regional institutions. At the beginning of the global financial crisis, Germany was
rather isolated, as support for Keynesian policy cooperation was strong among EU member states. Yet, as the German economy remained robust in stark contrast to other European economies, regional institutions such as the Frankfurt-based ECB gradually came to support the German-style conservatism. Just prior to the Toronto Summit, representative figures in EU-level policy choices, such as the ECB’s Jean-Claude Trichet and European commissioner of economic affairs Olli Rehn, justified the strategy of fiscal consolidation with the intention of rejecting the US demand to expand fiscal expenditure (Financial Times, 24 June 2010: 2).

Support from these regional institutions made Germany appear not to be behaving for its self-interest only. This means that Germany had alternative institutional resources from which to derive legitimacy on policy choices and thereby was able to be relatively indifferent to the US or US-led institutions. In contrast, there was no equivalent institution for China, so its assertiveness would have been more readily interpreted as selfish or irresponsible. In summary, the divergence of the two large surplus states’ hierarchical positions depended primarily on the existence of their own norms and institutional resources that support those norms.

5. Conclusion

This article has examined the situation in which the prime factor that brought uncertainty into informal economic institutions was not the rise of Chinese state capitalism, as conventional wisdom suggests, but actually the disagreement among major advanced states. To address this paradox, we introduced a framework of normative hierarchy in informal institutions, showing that the paradox can be mainly explained by the power disparity between the major Western states and China, which was attributable to the asymmetrical allocation of normative and institutional resources in each issue area. As confirmed through case studies, the asymmetry in resource endowment led to different degrees of vulnerability to pressure and expectation manifested in the international institutional processes.

In the case of international banking regulation, the US, as a norm supplier, which is endowed with legitimacy and technical knowledge for policy choices, was able to give priority to domestic policy adjustments and repeatedly delay the implementation of the Basel regulations. Such actions remain threatening for the effectiveness of international regulations. In contrast, China, as a norm demander, which needed technical knowledge and legitimacy to achieve domestic policy reform and to increase the recognition of its banks in global financial markets, implemented international regulations much more rigorously. Such positive and faithful attitudes towards the international institution were not undermined, even in the phase where the
demanding requirements of Basel III were anticipated to negatively affect Chinese banks and the national economy, or in the case when the US delay of implementation of Basel III could have disadvantaged Chinese banks. It is noteworthy that uncertainty of the effects of the Basel regulations was recognised in China as well. From the above analysis, it is clear that China’s attitude and behaviours cannot be reduced to material interests alone.

As for macroeconomic policy cooperation, Germany, which had established its own norms based on historical experience, was not a norm demander, meaning that it did not need to be authorised by the norm of Keynesian policy cooperation. This position enabled Germany to prioritise its own norms and policy goals and to supply them to other European states in those cases where it was supported by regional institutions. In China’s case, there was no alternative source from which to draw legitimacy and technical knowledge. Therefore, the adoption of the Keynesian policy cooperation was an attractive choice. The fact that China took on a huge burden of adjustment costs, such as local government debts and an investment bubble, suggests that its policy choices cannot be captured only in terms of economic self-interest.

The above analysis allows us to propose two implications: the first relates to the broader theoretical debate on international relations and the second to the political economy literature on the rise of China and other emerging states. First, constructivist-based literature on international relations generally assumes that the formation of international institutions based on norm diffusion contributes to the provision of international public goods and promotes relatively equal interstate relations. In contrast, this study focuses on the importance of paying attention to the other side effects of the formation: it could lead to the maintenance and reproduction of asymmetrical interstate relations originating from an asymmetrical distribution of power resources.

Second, the impact of the rise of China on global economic governance after the financial crisis may be less significant than has often been thought. The establishment of the G20 leaders meeting and the enlargement of the Basel Committee, or the transformation of the Financial Stability Forum into the FSB, may appear to be a sharp disjuncture with US or Western-centred economic governance. At the same time, it is also possible that key normative and institutional resources are still exclusively held by the major Western powers in certain issue areas in which informal institutions play crucial roles as in the issue areas this paper addresses. The same points can conceivably be applied to other BRICS countries, since their power resources and overall economic size are much smaller than those of China. Given the increasing importance of informal institutions after the breakdown of the Bretton Woods system, we should be more sceptical about the popular narrative that a radical transformation of the power structure in global economic governance is already in progress.
Acknowledgement

The author is grateful to the College of Asia and the Pacific of the Australian National University for its generous support during his stay as a visiting fellow.

Notes

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1. Indeed, the negotiation over the capital adequacy ratio of 8% was said to be controversial, since the figure lacked enough theoretical and empirical support (Davies and Green, 2008: 38).

2. Based on the influential roles of US-based bankers’ associations in the making of Basel II, it is widely regarded as a representative case of regulatory capture. See, for example, Mattli and Woods (2009: ix).

3. “‘Full text’ of Chinese President’s Speech at G20 summit in Pittsburgh”, BBC Monitoring Asia Pacific, 26 September 2009.

4. An official daily newspaper of the Shanghai Committee of the Communist Party carried an article arguing that it was welcomed that China did not become a topic of argument in Toronto. “Zhongguo meicheng huati” (“China did not Become a Topic”), Jiefang Ribao, 29 June 2010, p. 6.


6. China’s recent efforts to establish its own influential institutions like the BRICS Development Bank and the Asian Infrastructure Investment Bank can be seen as attempts to enhance institutional resources to support its norms and ideas.

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- BBC Monitoring
- China Daily
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- EIU ViewsWire
- Euroweek
- Financial Times
- Huanqiu Caijing
- Huanqiu Wang
- Jiefang Ribao
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- Renmin Ribao, Overseas Edition
- Shanghai Zhengquan Bao
- Shehui Kexue Bao
- The Guardian
- Wall Street Journal
- Xinhua Wang
- Yingcai
Research Notes
Effective Corporate Board Structure and Agency Problems: Evidence from China’s Economic Transition

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Abstract
This study investigates the determinants of Chinese board structure during the economic transition from the year 2000 to 2012. It uses principal component analysis with fixed effects estimation to test three hypotheses – the scope of operation hypothesis, monitoring hypothesis and bargaining hypothesis – using different subsamples. Explained without the use of mathematical rigor, the paper’s main findings are that Chinese stock market liberalization and the ultimate controlling shareholder are important factors when constituting board structure. After the split-share structure reform, China tends to have an outsider-dominated board structure. While private-controlled enterprises are more efficient in constituting board structure, CEOs of state-controlled enterprises have more bargaining power over board structure.

Keywords: China economic transition, corporate governance, board structure

1. Introduction
The corporate board serves the most important role in corporate governance. Exploring factors influencing board structure are fundamental in understanding the role of board directors in improving corporate governance. Previous studies suggested that a corporate board is constituted jointly by reconciling two conflicting views (Boone et al., 2007). One is the efficient board hypothesis that board structure is efficient and there is no need to regulate. The other is the inefficient board hypothesis, which argues that a corporate board is naturally structured inefficiently. Firms should adjust board structure according to the cost and benefit of board monitoring and firm-specific characteristics in order to achieve the optimal board structure. Based on these two competing views, previous studies were of the view that in most cases, the corporate board structure is jointly determined by the scope of operation.
hypothesis, monitoring hypothesis and bargaining hypothesis (Hermalin and Weisbach, 2001; Arthur, 2001; Iwasaki, 2008; Combs et al., 2007; Lehn et al., 2009).

Studies of this topic on the developing economies are few. This is certainly the case for China, with some studies of Chinese board governance covering only the initial stages of Chinese economic transition (Chen and Al-Najjar, 2012). Recently, however, Chen’s (2014) study on Taiwan, Germain et al.’s (2014) study on Malaysia and Iwasaki’s (2008) study on Russia have begun to shed light on the developing and transforming countries with institutional settings and characteristics that differ from those in advanced economies. This study makes comparisons with existing studies by addressing particular issues related to Chinese board structure during the period from 2000 to 2012.

This study focuses on China because its corporate sector has grown to include some of the largest firms in the world,¹ and the country has been undergoing economic transition during the last three decades. Chinese economic transition is a gradual process and follows the path of partial privatization of state enterprises. The largest enterprises are also increasingly seeking listing in China’s and foreign stock exchanges. While, Chinese listed firms are divided into state and private enterprises, there are also firms for which ownership is unclear (Cheong et al., 2014). However, because this ownership ambiguity is hard to clarify, this paper has to rely on the official definitions of state-controlled and private-controlled enterprises. Still, China’s split-share structure reform in 2005 that converted non-tradable shares into tradable shares has moved Chinese corporate governance closer to that characterized by market-orientation. In addition, agency theory-based government regulations towards hiring independent directors is another driving force for listed firms to adjust their board structure.

The structure of this paper is as follows. Section 2 reviews the literature on the determinants of board structure. Section 3 examines China’s corporate governance issues, including the split-share structure reform and enterprises. Section 4 provides the specification of the research methods and the data used for estimation. Section 5 shows the empirical findings. Section 6 concludes by drawing several implications.

2. Literature Review

The literature on the determinants of board structure is generally framed by three basic theories, namely the resource dependent theory, agency theory and power circulation theory. The resource dependent theory argues that the main function of the corporate board is to give advice and information needed to facilitate the firm’s decision-making and strategic choice (Hillman and
Dalziel, 2003; Pugliese et al., 2014). From the agency theory’s perspective, however, the corporate board functions to monitor the interaction between managers as the agent and shareholders as the principal, and on behalf of the latter (Fama and Jensen, 1983; Shleifer and Vishny, 1997; Hillman and Dalziel, 2003). The power circulation theory applied to corporate governance suggests that CEOs can gain power from a coalition dominated by themselves, however, their power is constrained by a coalition formed by rival directors and executives (Shen and Cannella, 2002; Ocasio, 1994; Henderson and Fredrickson, 2001).

Based on these theories, three basic hypotheses have been proposed. The scope of operation hypothesis proposed that board size and independence depend on the amounts of advice and resources needed for a firm’s daily operations. As firms grow and diversify over time and space, the increased number of product lines and services require the firms to have a larger specialized board to conduct planning, auditing and advising tasks (Lehn et al., 2009). In addition, firms with a larger scope of operation are usually faced with more serious agency problems than smaller firms, so that more outside directors need to be nominated to monitor managerial behaviour (Boone et al., 2007; Coles et al., 2008; Chen and Al-Najjar, 2012).

The monitoring hypothesis states that board size and independence are driven by the tradeoff between the cost and benefit of board monitoring. The cost of monitoring is related to the complexity of a firm’s operating environment (Gillan et al., 2003; Demsetz and Lehn, 1985). Firms with high growth potential and greater information asymmetries are costly for board to monitor (Linck et al., 2008; Lehn et al., 2009), while, the benefits of monitoring depend on the level of private benefits available to managers (Lehn et al., 2009; Boone et al., 2007).

The bargaining hypothesis postulates that board size and the proportion of outside directors are the result of a CEO’s bargain with the rest of the board directors. A CEO’s bargaining power comes from his/her potential ability to influence the appointment of board directors (Hermalin and Weisbach, 1998; Arthur, 2001). Directors appointed through the CEO are inclined to stand with the CEO. Arthur (2001) and Baker and Gompers (2003) suggested that the proportion of outside directors is negatively related to a CEO’s power, since a powerful CEO faces less monitoring by outside directors. A CEO’s influence on board structure may also be constrained when more powerful outside directors and shareholders exist.

Among the empirical works addressing these hypotheses, Guest (2008) studied the determinants of board structure in the UK and found that they varied across different institutional settings. The UK’s board structure is less determined by monitoring related factors. However, the US board structure is determined by the tradeoff between the benefits of information brought by
additional directors and the coordination costs engendered by them (Lehn et al., 2009). In another study, Russia’s board structure is primarily determined by bargaining-related variables and the country as a transition economy also has an influence on board structure (Iwasaki, 2008). Malaysia’s board structure is determined by the scope of operation and only board size is determined by the monitoring factors (Germain et al., 2014). Taiwan’s board structure is determined by firm-specific and CEO characteristics as well as government regulations (Chen, 2014).

3. China’s Corporate Governance Issues

In the case of China, its transformation from a centrally planned to market oriented economy since 1978 is likely to affect the relationships discussed in Section 2. In this process, corporate governance was transforming from a government-dominated to market-oriented corporate structure. The continuously changing institutional landscape is also an important factor. Two specific issues pertaining to corporate governance are the split-share structure reform and controlling shareholder.

3.1. The Split-share Structure Reform

The “split-share structure” reform in 2005 is an important milestone of China’s privatization and transformation towards a market-oriented economy. Prior to the reform, less than one third of the total number of shares of enterprises could be traded freely in the stock markets. Because of this split-share structure, the benchmark of Shanghai Stock Exchange Composite Index had fallen substantially even though the economy was booming (Jiang et al., 2008). Hence, the aim of this reform is to revitalize the depressed Chinese

Table 1 Summary of the Hypotheses and Effects

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Effect</th>
</tr>
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<tbody>
<tr>
<td>Scope of operation hypothesis</td>
<td></td>
</tr>
<tr>
<td>Resource and advice needed (SCOPE)</td>
<td>Positive effects</td>
</tr>
<tr>
<td>Monitoring hypothesis</td>
<td></td>
</tr>
<tr>
<td>Cost of monitoring (COST)</td>
<td>Negative effects</td>
</tr>
<tr>
<td>Benefit of monitoring (BENEFIT)</td>
<td>Positive effects</td>
</tr>
<tr>
<td>Bargaining hypothesis</td>
<td></td>
</tr>
<tr>
<td>CEO’s influence (CEO’S)</td>
<td>Negative effects</td>
</tr>
<tr>
<td>Contrains on CEO’s influence (CEO LIMIT)</td>
<td>Positive effects</td>
</tr>
</tbody>
</table>
stock markets caused by the split-share structure. To implement this reform, the China Securities Regulatory Commission (CSRC) announced that 84 listed firms would participate in the pilot reform program. For these firms, non-tradable shareholders had to negotiate with tradable shareholders for a satisfied compensation in order to gain liquidity in the stock market on April and June 2005. In August 2005, a full-scale reform including all the listed firms began and by the end of 2007, 1,254 companies representing 97% of the total “A” share market capitalization had completed the reform (Li et al., 2011).

The split-share structure reform had a major impact on corporate governance. Prior to the split-share structure reform, Chinese enterprises were less subject to stock market discipline. The controlling non-tradable shares were owned by the Chinese government, which was alleged to have little regard for the efficient use of capital. For example, transfers of funds had been made from profitable divisions to unprofitable divisions (Scharfstein and Stein, 2000). In addition, the Chinese government did not represent the interests of domestic investors. The conflict of interest between tradable shareholders and non-tradable shareholders brought difficulties for Chinese corporate governance. For example, first, the pricing mechanisms of these two kinds of shares were completely different. Non-tradable shares were valued at book value, so that non-tradable shareholders could not benefit from capital gains from the stock market. In contrast, tradable shares were valued at market price and traded freely among domestic investors in the stock markets (Liao et al., 2014). Second, the Chinese government as controlling shareholder had non-market motives rather than profit maximization and shareholder’s protection. Economic growth, maintaining a higher employment rate and social stability were more important than domestic investors’ pursuit of profit maximization. The government as shareholder could use either political instructions or corporate control rights to divert the money invested by domestic investors to related parties for other uses. Third, most of tradable shareholders were opportunistic investors seeking short-term gains, as evidenced by its high turnover ratio and high stock return volatility (Liao et al., 2014).

Since the China Securities Regulatory Commission (CSRC) as the main regulator of the Chinese stock market bore most of the corporate governance responsibilities of listed companies and security firms (Chen et al., 2006), it issued in January 2001 the “Code of Corporate Governance for Listed Firms in China” (Oliver et al., 2014) to try to deal with the above problems. The “Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies” stipulated that all Chinese listed companies must have at least two independent directors by 30 June 2002 and at least one third of independent directors on the board by 30 June 2003 (Yang et al., 2011).
3.2. State Control versus Private Control

After the split-share structure reform, some state-owned enterprises (SOEs) were fully privatized, while others were still controlled by the Chinese government or its agencies through either retaining ownership before they went public, or purchasing the tradable shares from the open market (Li, 2010).

State-controlled enterprises enjoyed financial privileges not available to private-controlled enterprises, while private-controlled enterprises were more likely influenced by market forces and resemble their counterparts in developed countries (Wei et al., 2014). Banks were willing to lend to state enterprises since the government would share the losses with the banks if the firms were unable to repay the loans (Liang et al., 2012). The Chinese government also provided political and financial support, such as a reduced tax burden and debt-for-equity swap to reduce the enterprises’ debt burden (Sun and Tong, 2003). Besides, state-controlled enterprises had better opportunities to enter the stock market to raise funds. Private-controlled enterprises enjoyed none of these privileges, were subject to market discipline, but had a free hand in pursuing entrepreneurial objectives.

State-controlled enterprises are alleged to select CEOs largely based on social or political objectives, while private-controlled enterprises choose CEOs largely based on their ability to maximize shareholder’s wealth (Berkman et al., 2012). CEOs of state-controlled enterprises are supervised by the Chinese government, their performance at least partly assessed by how well they comply with the government’s economic, political and social objectives. Most of their incentives come from the opportunity to be promoted to the higher hierarchies in the government (Chen et al., 2009). CEOs in state-controlled enterprises have been criticized for being more interested in pleasing government officials than acting in the best interest of the company (Li et al., 2007). However, in private-controlled enterprises, large shareholders usually have better knowledge of the industry in which the firms operate. They prefer CEOs to be selected among themselves (Chen et al., 2009).

4. Research Methods

4.1. Factors Specification

Quantitative methods are used to verify the above hypotheses in the China context. The specific method is the principal components analysis. Board size, the number of directors on the board, and board independence, the percentage of independent directors on the board, are specified as being determined by the following factors and sub-factors:

- SCOPE, resources and advice needed for the firm’s operations and is used to test the scope of operation hypothesis. It is hypothesized that board
size and board independence increase with a firm’s scope of operations. SCOPE extracted from the firm’s age, its size and capital expenditure. Firm age is the number of years since the firm is established. Firm size is the natural logarithm of the firm’s total assets. Capital expenditure is the ratio of firm’s net change in fixed assets and depreciation divided by firm’s total assets.

- **COST**, the cost of monitoring. The cost of monitoring is related to the firm’s growth opportunity and information asymmetry. Firms with higher growth opportunities and higher information asymmetries are difficult to monitor. Since the management covered some firm specific information, that unknown to outsiders, thus, it is costly for firms to transfer this information to the corporate board.

- **BENEFIT**, the benefit of monitoring relates to the opportunities for managers to gain private benefits at the expense of shareholders’ interests. Following Boone *et al.* (2007) free cash flow is an important source of discretionary expenditure that the managers may use to pursue private benefits rather than shareholders’ wealth. Meanwhile, firms in a concentrated industry are subject to less market discipline. Therefore, managers find it easier to extract private benefits. Managers of firms with higher industry concentration could be subject to less market discipline and managers are better able to extract private benefits (Gillan *et al.*, 2004).

- **CEO**, the CEO’s influence represents the CEO’s bargaining power over corporate board composition. When CEO has the bargaining power, he/she would prefer less monitoring from independent directors, leading to a less independent board. Specifically, CEO duality indicates a phenomenon when CEO is the leader of both management team and the corporate board, that will increase CEO’s power. In addition, CEO’s ownership in the firm also gives CEO more power.

- **CEO LIMIT**, constraints on the CEO’s influence represents the limitation of CEO’s bargaining power over board composition. This factor is extracted from ownership concentration, and the supervisory board size. Ownership concentration represents the interests of large shareholders in the firm, it limits CEO’s power in corporate board since large shareholders are more likely to involve themselves in the corporate board’s decision making process. Besides, the supervisory board size is likely to constrain CEO’s influence, since the key function of supervisory board is to monitor managerial behaviours.

These factors are themselves determined by a host of sub-factors, including firm size, firm age, the amount of capital expenditure, a firm’s potential growth, free cash flow, industry concentration, CEO duality, CEO
ownership, ownership concentration, and the size of the supervisory board. Factors and sub-factors will be called independent variables. The analysis has been done for both the pre- and post-split-share reform periods.

4.2. Sample and Data

The sample for this study is the Chinese non-financial firms listed on the Shanghai and Shenzhen Stock Exchanges. 172 firms are selected and firms that are not continuously listed during the period between 2000 and 2012 are not included in the sample. Since the split-share structure reform took place in 2005, the sample for this study is divided into sub-samples, one pre-reform from 2000 to 2005 and the other post-reform from 2006 to 2012. In each subsample state-controlled enterprises with 625 observations are distinguished from private-controlled enterprises. Financial data and corporate governance data are available in companies’ annual reports and collected by the China Stock Market and Accounting Research database (CSMAR). Data regarding controlling shareholders are collected from the CCER database and CSMAR database.

5. Findings and Analysis

5.1. Descriptive Analysis

Chart 1a and Chart 1b show the means of board size and independence during the periods between 2000 and 2012. Overall, board size has decreased slightly over time, the peak size being in 2002 and 2003, remaining at around 9 persons thereafter. The board size of state-controlled enterprises is larger than of private-controlled enterprises. Board independence increased significantly from around 3 per cent in 2000 to 33 per cent in 2003 and rising gradually thereafter, with private-controlled enterprises enjoying greater independence than state-controlled enterprises. Also, before the year 2005, board independence was significantly lower compared to later years. The split-share structure reform and government regulations covering corporate governance, increased board independence more than board size, meaning that Chinese corporate board structure was transformed from being insider-dominated to outsider-dominated.

Table 2 summarizes the results of statistical tests for differences in the above independent variables before and after the split-share structure reform, and for state-controlled enterprises and private-controlled enterprises. The figures show, interestingly, that the impact of reform was to increase resource and advice requirements, monitoring cost, CEO’s influence and constraints on CEO behaviour, but to reduce the benefits of monitoring. As
between state-controlled enterprises and private-controlled enterprises, the latter required more resources, garnered more monitoring benefits, and their CEOs were more subject to constraints than state-controlled enterprises. The converse of these findings was that they entailed less monitoring costs and CEO influence.

### 5.2. Findings

Tables 3 and 4 show the estimated impact of the determinants of board size and board independence. By examining the statistical significance of coefficient estimates, the determinants of board size cannot strongly support the *scope of operation hypothesis*, *monitoring hypothesis* and *bargaining hypothesis* (Table 3). For the determinants of board independence, the *scope of operation hypothesis* and *monitoring hypothesis* can be supported, while, the *bargaining hypothesis* cannot (Table 4).
### Table 3 Determinants of Board Size

<table>
<thead>
<tr>
<th>Factors</th>
<th>Full</th>
<th>Before</th>
<th>After</th>
<th>State Control</th>
<th>Private Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCOPE</td>
<td>-0.0206</td>
<td>0.453**</td>
<td>-0.130***</td>
<td>-0.0418</td>
<td>-0.0206</td>
</tr>
<tr>
<td>COST</td>
<td>-0.0386</td>
<td>-0.140</td>
<td>-0.0175</td>
<td>-0.0322</td>
<td>-0.0310</td>
</tr>
<tr>
<td>BENEFIT</td>
<td>0.0870*</td>
<td>Positive</td>
<td>0.0998</td>
<td>0.0721</td>
<td>0.0581</td>
</tr>
<tr>
<td>CEO LIMIT</td>
<td>0.495***</td>
<td>Positive</td>
<td>0.653***</td>
<td>0.507***</td>
<td>0.396***</td>
</tr>
</tbody>
</table>

Note: *, ** and *** denote levels of statistical significance, *** being the highest.

### Table 4 Determinants of Board Independence

<table>
<thead>
<tr>
<th>Factors</th>
<th>Full</th>
<th>Before</th>
<th>After</th>
<th>State Control</th>
<th>Private Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCOPE</td>
<td>0.0276***</td>
<td>Positive</td>
<td>0.0830***</td>
<td>0.00898***</td>
<td>0.0242***</td>
</tr>
<tr>
<td>COST</td>
<td>-0.00874**</td>
<td>-0.138***</td>
<td>0.00139</td>
<td>Differ</td>
<td>-0.0303***</td>
</tr>
<tr>
<td>BENEFIT</td>
<td>0.00689*</td>
<td>Positive</td>
<td>0.0143*</td>
<td>Differ</td>
<td>0.0105*</td>
</tr>
<tr>
<td>CEO LIMIT</td>
<td>-0.00172</td>
<td>0.00695</td>
<td>0.00177</td>
<td>-0.00135</td>
<td>-0.00269</td>
</tr>
</tbody>
</table>

Note: *, ** and *** denote levels of statistical significance, *** being the highest.
Specifically, for the scope of operation hypothesis, the greater scope of operation led to a more independent board rather than larger board. Although, according to the resource dependent theory, the greater scope of operation means more resources and advice needed for the corporate board to undertake monitoring and advising activities. However, a larger board size is not always effective, since a larger board size is slower in decision-making and more difficult in coordinating among directors. Whereas, independent directors should be more objective in monitoring managerial behaviour and can provide expert knowledge better than inside directors. Therefore, the greater scope of operation leads to a more independent board.

For the monitoring hypothesis, the estimates suggest that when the firms have more information unknown to the outsiders, more independent directors are needed to guard against managers’ self-serving behaviour. Even greater information asymmetry imposes a greater cost through the need for more outside director monitoring, firms will still want to add independent directors as long as monitoring benefits outweigh the costs. In addition, the estimates show that greater industry concentration led to a more insider-dominated board structure. Since an insider-dominated board structure makes it easier for managers to pursue self-interests in a concentrated industry where market discipline is lacking. Generally, board size and independence decrease with the cost of monitoring (COST) and increase with the benefit of monitoring (BENEFIT).

As for the bargaining hypothesis, the empirical results suggest that ownership concentration and supervisory board size as constraints of CEO’s bargaining power (CEO LIMIT) play a substitute role to independent directors. As a result, board structure tends to be insider-dominated. However, CEO duality and CEO ownership of the firm, which reflect the CEO’s bargaining power (CEOINFLU) over board structure was found to have no significant impact. Overall, CEO’s bargaining power over board structure is quite limited, while those mechanisms constrain CEO’s bargaining power tend to substitute the monitoring role played by independent directors.

As for the investigated subsamples, the main differences between the before and after reform periods are the relationships between resources and advice needed (SCOPE) and board size, as well as the link between monitoring (COST&BENEFIT) and board independence. The estimates suggest that with the liberation of the Chinese stock market, the listed firms tend to reduce their board size, even though the scope of their operations must have been growing. This is likely because a large board size has many disadvantages such as the high direct cost of director’s compensation, slower decision-making and difficulty in coordinating among the board directors. Thus, after the reform, with the greater influence of stock market, domestic investors and a smaller government role, firms have chosen to reduce the
board size to save costs and improve efficiency. In addition, prior to reform, board independence was limited by monitoring cost. However, after reform, board independence is not significantly reduced by monitoring cost. This is likely because the role of independent directors in corporate governance is more pronounced after reform.

In terms of control, private-controlled enterprises are more concerned about the tradeoffs between cost and benefit of board monitoring when constituting board structure. This is because private-controlled enterprises are more profit oriented. State-controlled enterprises are less concerned because they enjoy government support and find it easier to get capital from banks. Another difference between state-controlled enterprises and private-controlled enterprises is the constraints of CEO’s influence (CEO LIMIT). Ownership concentration tends to substitute for the monitoring role played by independent directors in private-controlled enterprises more than state-controlled enterprises, suggesting a less independent board structure in these firms.

6. Conclusion

Chinese economic transition and state enterprise reform are hotly debated issues. Among the widely discussed approaches, China appears to prefer the property rights approach in terms of its policy of “holding to the large and letting go of the small”. The government keeps control rights over major state-controlled enterprises, but their objective of strengthening efficiency is within the government’s strategic objectives. The smaller state-controlled enterprises go public through the issue of shares with efficiency maximization the most important objective (Li, 2010).

The establishment of the Shanghai and Shenzhen Stock Exchanges in the 1990s and the split-share structure reform in 2005 are important milestones in the Chinese privatization process. Chinese corporate governance reform, especially corporate board governance reform is a step in this direction. This study contributes to this discourse by taking into account the specific reform measures, split-share reform and the strategic shift from ownership to control.

The split-share structure reform that converted non-tradable shares into tradable shares greatly liberalized ownership in the Chinese stock market. It subjected Chinese listed firms to more stock market discipline and domestic shareholder’s monitoring. This study showed that the role of independent directors in corporate governance gained more prominence after this reform. Firms opted to reduce inside directors rather than add independent directors to save cost. This is a clear indication that firms recognize the value of independent directors’ monitoring.
This study also found that with assured financial and political support from the government, state-controlled enterprises are less efficient in constituting board structure than private-controlled enterprises. Private-controlled enterprises are more concerned about the cost and benefit of board monitoring than state-controlled enterprises. Besides, CEOs of state-controlled enterprises have more opportunities to pursue self-interests through their bargaining power when constituting board structure. Therefore, state-controlled enterprises usually have an insider-dominated board structure with fewer independent directors when their CEOs hold considerable power.

Given that the objectives of state-controlled enterprises and private-controlled enterprises do not fully coincide, it is neither possible nor appropriate to pass judgment on either. Nevertheless, these major reforms have achieved the objectives of greater accountability and better performance even in the state-controlled enterprises. Although one may quibble about the pace of reform, the findings of this study support the ongoing approach of government control applied to only strategic enterprises while retaining ownership in others. Even for the latter, there is an increasing trend towards professionalization of corporate boards (Cheong et al., 2014).

Notes

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1. Such as Sinopec Group, China National Petroleum and State Grid which were listed on Fortune Global 500 in 2014.
2. “A” share is a share issued by Chinese firms that are listed on Chinese stock markets and is only allowed to be traded among domestic investors.
3. Details of the quantitative methods used are available upon request. Principal components analysis is a factors reduction method used to extract key information from several sub-factors.
4. According to the CSRC, independent directors are those who have no other positions in the company and have no relationships with the company’s major shareholders that might affect their independent and objective judgment.

References


Understanding the Economic Diplomacy between the Philippines and China*

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Abstract
When Philippines-China relations turned for the worse after the Scarborough standoff in 2012, concerns were raised about possible coercive levers, particularly economic sanctions that China might impose. This study enlarges the domain of analysis and focuses on economic diplomacy to contextualize China’s approach within the ambit of its foreign economic relations with the Philippines. Following the framework of Okano-Heijmans (2011:16-20), economic diplomacy not only serves the national interest by acting strategically in securing a constant supply of critical resources, opening new markets for exports or finding new opportunities for investments. It also covers the use of economic statecraft in advancing foreign policy objectives. The research looks at empirics on trade, investment and aid, and juxtaposes the analysis with that applied to qualitative content from primary materials on bilateral agreements.

Keywords: Philippines-China, foreign economic relations, strategic studies

1. Introduction
As the Philippines-China maritime tension escalated, various sectors flagged concerns on possible economic coercion by China. The constraining of trade, blacklisting of Philippine companies in investment bids, negative tourist advisories are just a few fears. On the other hand, questions have been raised on whether the Philippines will diversify away from China or resort to a nationalist boycott. While exploring the Philippines’ vulnerability to possible sanctions from China and reactions is a burning question (Clemente, 2014), this research note seeks to shed light on the pattern of bilateral economic diplomacy to contextualize within this picture, China’s actions towards the Philippines. Government planners may use the research to reconsider the Philippines’ economic strategies in the context of national security and better understand China’s economic statecraft.
Using official primary documents on agreements such as treaties and communiqués, a meticulous content analysis in processing qualitative content was applied. Secondary sources such as reports, news and commentaries were used as supplementary material in ascertaining information where access to primary content was limited. Agreements that related to economic diplomacy were then coded according to a classificatory instrument that allowed the framing of interests in an economic diplomacy spectrum where commercial gain and stability are binary extremes.

The next section presents data on the bilateral economic engagement in trade, investment and official development assistance. The third section analyses patterns in the bilateral agreements. The fourth section provides a brief word on new questions pertaining to China’s recent grand initiatives. The paper ends with closing remarks.

2. Trade, Investment and Aid: What the Numbers Confess

2.1. Trade

Trade with China proceeded at a glacial pace since 1975, but it leaped forward sharply in the 21st century. Except for the drastic dip associated with the global financial crisis, the relative uptick in trade is a fairly recent phenomenon. Figure 1 shows that both exports to and imports from China

Figure 1  Philippines Exports to and Imports from China, 1975-2014
(F.O.B. value in USD millions)

likewise started surging in the beginning of the 21st century except for the large dip in exports owing to the global financial crisis. It is noteworthy that when advanced economies in the West took a hit, this meant that China’s major export markets were compromised. Philippine exports posted a sizeable drop as Philippine exports were linked to China’s exports to the West (Tong and Chong, 2010). The pattern of imports relative to exports shows that China has increasingly become important to the Philippines, owing to the fact that buyers of Philippine commodities are more diversified. While Philippine exports to China are more volatile, imports from China have been more stable. The balance of trade between the Philippines and China posted a deficit from 1975-2001 except for 1977. During the years 2002-2011, the balance of trade yielded a surplus except for the years 2004 and 2009. Curiously, the deficits in 2012-2015 raised concerns that they were caused by the maritime tension. The figures for 2013-2015 indicate the three highest deficits in the economic relationship.

However, China’s trade with the Philippines constitutes a small proportion of its total trade with the Association of Southeast Asian Nations (ASEAN) and an even smaller proportion of its trade with the world. Zhao (2013) contends that the Philippines did not take a proactive stance in crafting Free Trade Agreements (FTAs) with China and other economies. This view is consistent with the observation that the Philippines merely adheres to multilateral trade agreements rather than paves its own inroads. It is therefore not a surprise that relative to other nations in ASEAN, bilateral trade and investment with China have proceeded slowly. The value of China’s imports from the Philippines is the least among the economies in the ASEAN 5 (Indonesia, Malaysia, Philippines, Singapore and Thailand) but it happens to be greater than what it imports from Vietnam (Figure 2). Hence, as a supply market, the Philippines does not rank well in China’s scale of importance. As a market for China’s exports, the Philippines is the least significant among the ASEAN-5 and Vietnam in 2011-2015. The value of Philippine imports from China is less than half of Vietnam imports in 2015 (Figure 3). In other words, while the Philippines imports more than it exports to China, it does not import as much as the other economies in ASEAN. In the last three years, from 2013-2015, Vietnam is the top importer of Chinese goods.

2.2. Investments

In terms of investments, the Philippines invests more in China than China invests in the Philippines and was one of the first foreign investors in China. However, the value of Foreign Direct Investment (FDI) in China is too minuscule relative to the investments of other ASEAN economies. Regarding China’s investments in ASEAN, Figure 4 shows that it is only Brunei that has
Figure 2  China’s imports from each ASEAN member, 2011-2015 (USD billions)


Figure 3  China’s exports to each ASEAN member, 2011-2015 (USD billions)

2.3. Official Development Assistance (ODA).

The focus of ODA projects in the Philippines can be structured in the following five priority sectors: agriculture, natural resources and agrarian reform; governance and institutions development; industry, trade and tourism; infrastructure; social reform and community development (National Economic Development Agency, 2012). In 2012, ODA from China went to projects that focused on water utilization, aqueduct improvement and irrigation, directly impacting the agriculture, natural resources and agrarian reform sector and affecting the rest of the sectors indirectly. Table 1 shows that China is ranked 11th among 18 development partners in terms of the total ODA composed of loans and grants. China’s total share in total ODA stood at 0.84 per cent as of December 2014. From 2003 to 2012, new ODA loans show that China’s total likewise lags behind that of the other development partners (Table 2).

3. Patterns in Bilateral Agreements

Agreements on trade, investment and finance outnumber all other types of agreements. In terms of the entire period of the diplomatic relationship from 1975 to the present, it was in 2007 that the number of total agreements peaked
Table 1 Total ODA by Development Partner in USD million as of December 2014

<table>
<thead>
<tr>
<th>Development Partner</th>
<th>Loan Amount</th>
<th>Grant Amount</th>
<th>Total ODA</th>
<th>Per Cent Share</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Bank</td>
<td>4,453.27</td>
<td>84.88</td>
<td>4,538.15</td>
<td>31.59</td>
<td>1</td>
</tr>
<tr>
<td>Japan</td>
<td>3,159.11</td>
<td>166.55</td>
<td>3,325.66</td>
<td>23.15</td>
<td>2</td>
</tr>
<tr>
<td>Asian Development Bank</td>
<td>2,231.70</td>
<td>118.24</td>
<td>2,349.94</td>
<td>16.36</td>
<td>3</td>
</tr>
<tr>
<td>United States of America</td>
<td>–</td>
<td>1,148.56</td>
<td>1,148.56</td>
<td>7.99</td>
<td>4</td>
</tr>
<tr>
<td>United Nations System</td>
<td>75.29</td>
<td>608.48</td>
<td>683.77</td>
<td>4.76</td>
<td>5</td>
</tr>
<tr>
<td>South Korea</td>
<td>524.75</td>
<td>93.84</td>
<td>618.59</td>
<td>4.31</td>
<td>6</td>
</tr>
<tr>
<td>Australia</td>
<td>–</td>
<td>587.02</td>
<td>587.02</td>
<td>4.09</td>
<td>7</td>
</tr>
<tr>
<td>France</td>
<td>436.95</td>
<td>0.54</td>
<td>437.49</td>
<td>3.04</td>
<td>8</td>
</tr>
<tr>
<td>Germany</td>
<td>55.30</td>
<td>124.66</td>
<td>179.96</td>
<td>1.25</td>
<td>9</td>
</tr>
<tr>
<td>European Union</td>
<td>–</td>
<td>174.55</td>
<td>174.55</td>
<td>1.21</td>
<td>10</td>
</tr>
<tr>
<td>China</td>
<td>115.33</td>
<td>5.70</td>
<td>121.03</td>
<td>0.84</td>
<td>11</td>
</tr>
<tr>
<td>OPEC Fund for International Development</td>
<td>70.00</td>
<td>–</td>
<td>70.00</td>
<td>0.49</td>
<td>12</td>
</tr>
<tr>
<td>Canada</td>
<td>–</td>
<td>54.74</td>
<td>54.74</td>
<td>0.38</td>
<td>13</td>
</tr>
<tr>
<td>Italy</td>
<td>34.21</td>
<td>3.84</td>
<td>38.05</td>
<td>0.26</td>
<td>14</td>
</tr>
<tr>
<td>Austria</td>
<td>25.64</td>
<td>–</td>
<td>25.64</td>
<td>0.18</td>
<td>15</td>
</tr>
<tr>
<td>Spain</td>
<td>–</td>
<td>9.34</td>
<td>9.34</td>
<td>0.07</td>
<td>16</td>
</tr>
<tr>
<td>Norway</td>
<td>–</td>
<td>4.34</td>
<td>4.34</td>
<td>0.03</td>
<td>17</td>
</tr>
<tr>
<td>New Zealand</td>
<td>–</td>
<td>0.69</td>
<td>0.69</td>
<td>0.00</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11,181.55</strong></td>
<td><strong>3,185.97</strong></td>
<td><strong>14,367.52</strong></td>
<td><strong>100.00</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Table 2  Historical New ODA Loans by Selected Development Partners (value in USD billions)

<table>
<thead>
<tr>
<th>DPs</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>0.22</td>
<td>–</td>
<td>0.39</td>
<td>0.65</td>
<td>0.28</td>
<td>0.62</td>
<td>0.56</td>
<td>0.40</td>
<td>0.71</td>
<td>4.03</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>–</td>
<td>0.40</td>
<td>–</td>
<td>0.05</td>
<td>0.60</td>
<td>–</td>
<td>0.09</td>
<td>0.12</td>
<td>–</td>
<td>1.26</td>
<td></td>
</tr>
<tr>
<td>JICA</td>
<td>0.12</td>
<td>–</td>
<td>–</td>
<td>0.25</td>
<td>0.27</td>
<td>0.61</td>
<td>0.38</td>
<td>0.52</td>
<td>0.94</td>
<td>3.09</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>0.02</td>
<td>0.05</td>
<td>0.28</td>
<td>0.24</td>
<td>0.32</td>
<td>0.44</td>
<td>0.32</td>
<td>0.6</td>
<td>0.01</td>
<td>0.35</td>
<td>2.63</td>
</tr>
<tr>
<td>WB</td>
<td>0.11</td>
<td>0.06</td>
<td>0.09</td>
<td>0.41</td>
<td>0.39</td>
<td>0.44</td>
<td>0.12</td>
<td>0.74</td>
<td>0.76</td>
<td>0.33</td>
<td>3.45</td>
</tr>
<tr>
<td>Total</td>
<td>0.47</td>
<td>0.51</td>
<td>0.76</td>
<td>1.35</td>
<td>1.85</td>
<td>1.77</td>
<td>1.70</td>
<td>2.24</td>
<td>1.50</td>
<td>2.32</td>
<td></td>
</tr>
</tbody>
</table>

Source: National Economic and Development Authority (2012:11)
(Figure 5). We evaluate the agreements from sources such as the website of the Embassy of the Philippines in Beijing, the Supreme Court E-Library and Philippine Treaties Online. We then group agreements according to the modified list in Figure 6. Some categories were subsumed into or combined with other categories. Note that one agreement can yield a multiple number of areas of concern and likewise a multiple number of economic diplomacy types and subtypes, depending on the degree of comprehensiveness of the agreement’s scope. Figures 5 and 6 show that efforts to forge economic diplomacy have not been intense. A break from the relatively low number of agreements per year occurred in the 2001-2010 period. Furthermore, during the entire period of diplomatic relations, trade/investment/finance got the most number of agreements while agriculture and scientific/technical agreements ranked second and third.

This research also organized the agreements by presidential term by area of cooperation (Figure 7). The documentary sources begin in 1975, during the Marcos era, when the diplomatic relationship was forged. It was during the term of Gloria Macapagal-Arroyo when the so-called golden age of diplomacy was reached, with trade/investment/finance agreements still getting the most attention.

**Figure 5** Number of Bilateral Agreements per Year (1975-2015)

Sources: Embassy of the Philippines in Beijing, China, n.d.; Malaya, Oblena, and Casupanan, 2010; Supreme Court E-Library; Philippine Treaties Online; Carlos P. Romulo Library, Foreign Service Institute, Philippines, n.d.
**Figure 6** Frequency of Each Area of Concern in 138 Bilateral Agreements between the Philippines and China

<table>
<thead>
<tr>
<th>Area of Concern</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>27</td>
</tr>
<tr>
<td>Air services</td>
<td>3</td>
</tr>
<tr>
<td>Consular Affairs</td>
<td>7</td>
</tr>
<tr>
<td>Culture</td>
<td>11</td>
</tr>
<tr>
<td>Education</td>
<td>4</td>
</tr>
<tr>
<td>Health</td>
<td>1</td>
</tr>
<tr>
<td>Maritime Cooperation</td>
<td>1</td>
</tr>
<tr>
<td>Media, Communications, Information</td>
<td>4</td>
</tr>
<tr>
<td>Military, Defense</td>
<td>6</td>
</tr>
<tr>
<td>Prosecution, Criminality</td>
<td>6</td>
</tr>
<tr>
<td>Scientific, Technical</td>
<td>15</td>
</tr>
<tr>
<td>Sports Cooperation</td>
<td>6</td>
</tr>
<tr>
<td>Tourism</td>
<td>10</td>
</tr>
<tr>
<td>Trade/Investment/Finance</td>
<td>37</td>
</tr>
<tr>
<td>Youth</td>
<td>3</td>
</tr>
</tbody>
</table>

Sources: Embassy of the Philippines in Beijing, China, n.d.; Malaya, Oblena, and Casupanan, 2010; Supreme Court E-Library; Philippine Treaties Online; Carlos P. Romulo Library, Foreign Service Institute, Philippines, n.d.

**Figure 7** Number of Agreements Signed in Each Presidential Term, by Area of Concern

Sources: Embassy of the Philippines in Beijing, China, n.d.; Malaya, Oblena, and Casupanan, 2010; Supreme Court E-Library; Philippine Treaties Online; Carlos P. Romulo Library, Foreign Service Institute, Philippines, n.d.
The 83 areas of cooperation during the Arroyo administration focused on agriculture (20) and trade, investment and finance (23), overshadowing other areas of cooperation of interest to analysts: maritime (1), military and defense (4) and scientific & technical cooperation (6). These agreements were forged well before the breakout of the Scarborough incident. The Arroyo administration’s foreign policy involved a constant balancing between the US and China, export and investment promotion, Overseas Filipinos Worldwide (OFW) protection and multilateralism. Unfortunately, many agreements with the Chinese were embroiled in serious corruption charges (De Castro, 2010: 705-714).

Often, Chinese analysts would ask, what has changed in the policy of the Aquino administration as it sharply contrasts with the golden age of bilateral diplomacy during the Arroyo administration? What this empirical reflection shows is that the Aquino administration is not the outlier but the Arroyo administration is. The rest of the presidential administrations reflect the lacking relationship proximity between the Philippines and China. Alternatively, the Philippines has always been peripheral to China, geopolitically. Can we say the same for the reverse? In the Marcos era during the 1970s, communism in the world was on the rise, the US was defeated in Vietnam, and the oil crises caused a global economic shock. Marcos decided to re-open ties with China to access oil but also to hedge between powers. The Laurel-Langley Agreement, a trade pact with the US, was also going to end in 1974, making it more urgent for the Philippines to seek other markets for trade (Resos, 2015: 3-4). During Ramos’ time, he focused on development diplomacy, which strived to push the Philippines towards gaining new markets in the context of increasing globalization of production, labour, finance and services. Cooperative regional frameworks were also increasing. Ramos’ administration also saw the rising concern of non-conventional threats to security, which required better cooperation with states and international institutions. Notwithstanding the development policy, there were very few agreements with China and even fewer deals on economic cooperation. It was difficult for the administration to warm relations with China when it occupied the Mischief Reef in 1995 (Pattugalan, 1999: 131, 140). Estrada on the other hand likewise strived to bring in more foreign investment. Meanwhile, continued Chinese activity in the West Philippine Sea, including a runway that was built on Woody Island, made the administration uncomfortable (Singh and Freeman, 2000: 14).

Economic diplomacy instruments, which are not limited to sanctions, have varied instruments and goals, which must be plotted to elucidate patterns. Hence, this research applied the classificatory typology adapted from Okano-Heijmans (2011: 20) on the bilateral agreements. The typology first applied codes on major economic diplomacy types and their subtypes. Content from the agreements underwent meticulous manifest and latent coding to capture specific markers in classification (Table 3). Many agreements related
Table 3: Nature of Economic Diplomacy Agreements

<table>
<thead>
<tr>
<th>Commercial diplomacy</th>
<th>Trade Diplomacy</th>
<th>Financial diplomacy</th>
<th>Assistance/Cooperation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade promotion</td>
<td>20</td>
<td>3</td>
<td>1</td>
<td>18</td>
</tr>
<tr>
<td>Tariffs/Duties</td>
<td></td>
<td>Currency Swap</td>
<td>Grants/Loans/Financing</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agreements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Promotion</td>
<td>22</td>
<td>4</td>
<td>1</td>
<td>18</td>
</tr>
<tr>
<td>SPS and Quality</td>
<td></td>
<td>Establishment of</td>
<td>Technical</td>
<td></td>
</tr>
<tr>
<td>Regulation</td>
<td></td>
<td>Banking Institution</td>
<td>Cooperation</td>
<td></td>
</tr>
<tr>
<td>Tourism Promotion</td>
<td>10</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Quantitative</td>
<td></td>
<td>Unspecified</td>
<td>Fisheries/Agriculture</td>
<td></td>
</tr>
<tr>
<td>Restriction and</td>
<td></td>
<td></td>
<td>Cooperation</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>9</td>
<td>3</td>
<td>39</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>103</td>
</tr>
</tbody>
</table>

Sources: Embassy of the Philippines in Beijing, China, n.d.; Malaya, Obiena, and Casupanan, 2010; Supreme Court E-Library; Philippine Treaties Online; Carlos P. Romulo Library, Foreign Service Institute, Philippines, n.d.; Typology adapted from Okano-Heijmans (2011: 20).
to more than one major type of economic diplomacy (e.g. commercial diplomacy) and within this category, they pertained to more than one subtype of economic diplomacy (e.g. investment promotion and tourism promotion). In this light, such agreements were counted more than once. Coding required a close reading of each agreement, emphasizing the need for specific knowledge of economic diplomacy. This is where secondary material proved useful in triangulating the economic diplomacy type and subtype. Examples of content in secondary material that require specialized knowledge include provisions on the special treatment on rice; whether fisheries cooperation entails investment promotion or a political solution to common resource use (Wang, 2001); the intricacies of China’s ODA (Reilly, 2012); and when large-scale projects reflect investment or development assistance. Critiques of civil society also provide information (beyond the advocacy statements) that can be used to counter check details of the agreements (Francia and Ramos, 2011; De La Cruz, 2011; Aquino and Jensen-Joson, 2009).

Analysis of the bilateral agreements yielded a total of 103 economic diplomacy applications. Of these, 52 relate to commercial diplomacy, nine to trade diplomacy (i.e. decreasing trade barriers), three to financial diplomacy while 39 were related to financing assistance or cooperation of a technical, fisheries or agricultural nature. One can observe that in terms of frequency of efforts, commercial diplomacy is the most used instrument, followed by assistance/cooperation. With commercial diplomacy as a focus, investment and trade promotion are consistent with China’s rationalist commercial cost-benefit considerations. On the other hand, inducements reflect China’s preference for carrots and focused on assistance in financing projects as well as technical cooperation. Its sunshine policy towards the Philippines saw its golden age during the Arroyo administration.

While the preceding section on descriptive statistics emphasized the magnitude of major bilateral economic indicators, we direct attention to the importance of relating various economic diplomacy type within a larger strategic map. The x-axis represents tools while the y-axis represents goals. Tools get more economic (political) in nature as economic diplomacy moves towards the right (left) of the axis. Similarly, goals get more economic (political) in nature as economic diplomacy types are plotted lower (higher) on the map. While the location of each type of economic diplomacy within this map, as denoted by circles, is set by the conceptual framework, the magnitudes are not. The outcomes of the basic classification yielded frequencies for each economic diplomacy type, which in turn, determined the visual magnitude of each type in the spectrum. The resulting plot of magnitudes of economic diplomacy types is presented in the 4-quadrant prosperity-stability spectrum (Figure 8). The overall result of the spectral mapping shows how the state of bilateral economic diplomacy negotiates
Figure 8 Frequency of Each Typology of Economic Diplomacy


prosperity *vis-à-vis* stability. As a post-agreement evaluative instrument, Figure 8 depicts a paradigm of China’s multidimensional interests.

We see that China’s economic diplomacy approach towards the Philippines tips towards commercial diplomacy on one hand, where political tools are applied to secure economic deals with the Philippines. On the other hand, inducements or sunshine policies constitute the mode when economic tools are applied to achieve China’s political goals. For the entire diplomatic relationship since 1975, the economic diplomacy instruments show that China considers the Philippines merely peripheral to its overall interests. Interestingly, even in historical times, the Philippines remained on the outskirts of China’s trade interests, while not discounting the importance of the commodities that were traded (Wang, 2008). Before 2012, China seemed to have perceived the Philippines as more likely to give in to modest political demands with relatively little inducement (Ravindran, 2012: 115-125). The golden age of bilateral diplomacy during the Arroyo administration fits into this picture, which shows a surge in diplomatic acts. In turn, these tips the favour of decision-makers in the Philippines (De Guzman, 2014: 71-97) without being too costly, satisfying China’s rationalist considerations. This affirms the empirical finding on the Hu Jintao regime’s diplomacy that the latter is still driven by the primacy of economic interests (Shi and Yue, 2014: 10, 13). After the 2012 incident in the Scarborough Shoal, the Philippines
has become a flashpoint in the West Philippine Sea. From a standpoint of commercial cost-benefit thinking, China’s anaemic trade and investment interests in the Philippines actually speak of a rational calculus. Strategically speaking, Chinese assessment did not anticipate a more nationalist stance considering the weak reaction of the Philippines to the Mischief Reef incident in 1995 and the warm relations during the Arroyo administration.

4. Questions for the New Economic Diplomacy Architecture

China’s newest grand initiatives are the Belt and Road and the Asian Infrastructure Investment Bank (AIIB). At present, the Philippines is trying to grasp the breadth of implications of the 21st Century Maritime Silk Road (MSR), the component in the Belt and Road that applies to Southeast Asia. At any rate, these grand initiatives show that China’s new phase of economic diplomacy involves more deliberate efforts in shaping the external environment. Fresh approaches are reflected in the creation of new Free Trade Zones (FTZs), which epitomize attempts to veer away from project-based concessions of old while the AIIB is a bolder attempt at closer linkages with various economic regions (Zha, 2015: 100-104). The use of economic levers by China is not new. However, these initiatives generate great interest as to the geopolitical content that goes with crafting a new global economic architecture.

The analyses in the previous sections demonstrate in practical and operational terms, what existing literature has argued (Morada, 2009; Dagdag, 2005; Churchill, 1990) and what we continue to intuit from real world events: economic diplomacy instruments are highly contextual, involving a host of dimensions. The question now that arises is, how will the current bilateral economic diplomacy be nested in the new architecture? Such bilateral diplomacy has indeed been contextual in practice (Reilly, 2013: 4-5), which is consistent with China’s unilateral bilateralism or even unilateral multilateralism. In both instances, two features are vital. First, China’s linkages with a country or a group of countries are based on a relationship regardless of written pacts. The perspective here is that, it is the relationship, not power, that needs balancing. Second, the parameters of the relationship are driven by China regardless of the extent of accommodation it provides to the other country/countries (Shih and Huang, 2014: 5, 19, 22). It is then important to elucidate the scope of reciprocity and to be mindful of seemingly unconditional benefits as these are intended to have an indirect effect, which is to encourage political accommodation over time (Reilly, 2013: 4, 10).

Thinking about the new architecture will not be complete without considering the dynamics from other arrangements such as the Regional
Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership (TPP). There is no confusion that the MSR and AIIB are China’s development initiatives. However, in various dialogues, China’s perception that the TPP is the economic dimension of the US pivot to Asia and rebalance of China, tends to pit the TPP against the MSR, notionally. On the other hand, China openly supports the RCEP and the path towards the Free Trade Area of the Asia-Pacific, involving APEC countries, while aggressively pushing the MSR among countries in the region. Notwithstanding reservations towards China and relatively warm relations with the US, the Philippines prefers to avoid an “either-or” decision between China and the US. Potentially, the MSR provides benefits in infrastructure development while the projections on gains from joining the TPP while already an RCEP member, indicate potential improvement in economic activity as a whole and a potential leap in exports by “48.88% over the average export performance” (Clarete, 2014: 6). Nevertheless, even if TPP membership is projected to be beneficial for the Philippines, the required economic governance and competition policy have yet to arrive at full TPP-readiness. In this regard, the MSR is more inclusive. Formally, joining the TPP is at the behest of the vetting process, but the real burden lies on how the Philippines reform process can be expedited. It is noteworthy that similar projections on economic gains from the MSR and a detailed evaluation of participation requirements have not been given ample attention. Where ASEAN is concerned, strengthening the ASEAN Economic Community (AEC) helps insulate the Philippines from the economic rivalry between the US and China. However, institutional difficulties in the Philippines remain an impediment in realizing gains from the AEC. Certainly, multilateral agreements affect how the Philippines formulates strategic economic relations with China, which is not limited to trade, without necessarily constraining the potential for a mutually beneficial linkage.

5. Closing Remarks

The deconstruction of economic diplomacy according to a prosperity-stability map allows analysts of Philippines-China relations to ruminate on economic diplomacy goals and tools in a context that is deliberate and strategic. In practice, empirical research on economic diplomacy has much room for improvement. In developing countries, the tasks involved in trade and investment promotion activities overwhelm the foreign relations apparatus but even in these cases, empirical research on commercial diplomacy constitutes a gaping need. Much elucidation is needed even in such basic interrogations as organizational arrangements and commercial diplomacy approaches (Naray, 2008: 6-7, 10; Kostecki and Naray, 2007). The economy-security linkage has
long been recognized, but how this is translated into policy remains unclear even after years of graduate-level academic programs in special government institutions as well as cooperation between development-oriented and security agencies of government. Notwithstanding the challenges, the potential for economic diplomacy studies is great.

As the Philippines begins with a new presidential administration under Rodrigo Duterte, the government faces a tough task in reconsidering relations with China. Duterte had made statements that support the claims of the Philippines in the disputed area as well as the arbitration process and its verdict. On the other hand, his marked departure from the stance of the previous administration is reflected in his statements about being open to bilateral dialogue if the issue cannot be resolved after two or three years. Furthermore, he indicated his openness to the notion of joint exploration of the disputed area as this does not contradict the Philippines’ claims (Romero 2016; Ranada 2016). In spite of what China sees as a breath of fresh air, there is a need for the new administration to carefully consider how to deal with China. While multilateralism, involving ASEAN, the US and the middle powers, remains a channel to incentivize good neighbourliness from China, the Philippines must also increase its capability in effectively responding to China’s actions (Baviera, 2016). It is hoped that a deeper appreciation of economic diplomacy can improve strategic calculations.

Notes

* This research was funded by a research grant, which the author received in 2015 from the Asian Center, University of the Philippines Diliman. The author acknowledges the work of Pamela Combinido as research assistant.

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1. The rail infrastructure projects were cancelled.
2. In 2012, during the Aquino administration, the Philippines was a signatory in three multilateral agreements between ASEAN and China.

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Book Reviews
Book Review


A rising power’s desired foreign policy outcomes, to be successful, is often reliant on the state’s capability to utilize its military power. However, due to a globalized world, military power may no longer have the sole influence on how states can achieve their national interests overseas. China, one of the most dynamic players today in international politics, has used its economic power as leverage to achieve its desired foreign policy outcomes. Despite existing literature on economic statecraft as an alternative instrument in foreign policy decisions, majority would still assess China’s foreign policy through separate lenses of military and economic powers. On the other hand, while many of these references have stressed the separation between politics and economics, there is a growing body of literature that links these two disciplines, including this new book of William J. Norris. The book provides a compelling argument of how economic statecraft and the state’s limited power of control work within the context of China’s foreign policy.

Norris points out an important issue that may have been overlooked in the study of China’s foreign policy: the state’s effectiveness to manipulate international economic activities for strategic purposes depends on its capability to control the behaviour of its commercial actors. In this 10-chapter piece, the author convincingly proves his arguments by emphasizing economic statecraft in the context of China’s grand strategy and the Cross-Strait relations, China’s global search for strategic raw materials, and the country’s sovereign wealth funds as one of its sources of state capital. Norris observes that the state finds it difficult also to manage the behaviour of commercial actors in an effort to achieve the state’s strategic objectives. The Chinese state may find it more convenient to control its military actors yet commercial actors may tend to be more mobile and independent enough to veer away from state control. This, in turn, poses a challenge to China since most of the time commercial actors may not behave according to its interests due to their different goals. Fuelled by corporate interests, commercial actors may often stimulate conflict between the state and its neighbouring countries undetected and uncontrolled, putting the Chinese state at a disadvantageous position.
Norris concludes that economic statecraft can be a challenging instrument to use for the state in pursuing its national interests. In order to maximize the security of their strategic foreign policy goals, nations must have the capability to control or at least manage the behaviour of the commercial actors that carry out majority of the international economic activities. The prerequisite of an effective control of commercial actors by the state is the sustainability of state unity. In addition, the author recommends that as part of China’s international credibility-building, the state may have no choice but to acknowledge that liberal and market-based reforms are needed especially in its domestic political economy, as a way to also accommodate corporate actors and their interests.

While Norris mentions the importance of tackling China’s politics with its economic realities, the role of bureaucratic politics could have also been an interesting issue to explain the state’s eroding power over commercial actors. Underneath the political clout of the Chinese Communist Party, there exists a conglomerate of bureaucratic actors with their own partisan interests and goals away from that of the establishment and seeking greater influence through bigger resources in the government. This would have provided a stronger response to the enquiries regarding the limits of Chinese control. Given the situation, the state is faced with foreign policy decisions that have been bargained and compromised amongst various bureaucratic actors, resulting into a dilution of power on its part. Finally, the author could have considered as well selected case studies concerning Southeast Asia (SEA). The Chinese government, through its state-owned companies, have heavily invested in SEA, especially in the infrastructure sector. China, in effect, has become not only a competent trading partner for the region, but also a reliable investor that funnels in huge foreign direct investments.

Nevertheless, the book is a well-written analysis of economic statecraft in the context of China’s foreign policy. Norris has eloquently provided an innovative and at the same a comprehensive angle on how to assess and understand more constructively the selected issues and concepts surrounding China’s foreign policy and the state’s utility of economic statecraft. This latest and enlightening scholarly work of Norris is highly recommended for foreign policymakers and researchers, journalists, university students, and people working in the financial and trade industries.

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Book Review


The rise of China has been one of the most conspicuous topics in the academia. Among the numerous works on this topic, Edward Luttwak’s *The Rise of China vs. the Logic of Strategy* hoists his own unique banner. In this book, Luttwak highlights the “logic of strategy”, that is, less can be better than more (p. 66). In Luttwak’s opinion, this logic is not only “the universal logic of strategy applies in equality to every culture in every age” (p. vii), but also applicable to explain the challenges facing the rise of China.

This book has 22 chapters. Chapters 1-8 evaluate the dynamics of China’s rise in the fields of economy, politics, foreign affairs and defence, and explore the reasons why China’s neighbouring countries and external powers (particularly the United States) were anxious to hedge and/or balance China’s rise. In the following pages (chapters 9-12), Luttwak analyzes two tragic examples provided by Wilhelmine Germany (from the late 19th to the early 20th centuries), and Germany’s involvement in the world wars. According to Luttwak, history always repeats itself. Chapters 12-21 stress the responses of China’s neighbouring countries and external powers, such as Australia, Japan, Vietnam, South Korea, Mongolia, Indonesia, Philippines, Norway and the United States. In the opinion of Luttwak, it does not exclude the possibility that there would be a potential alliance against China’s rise. In the concluding chapter, Luttwak highlights his arguments.

Following Luttwak’s logic of strategy, it’s impossible for China to maintain sustainable economic growth and military growth at the same time. If China’s search for rapid economic and military growth beyond “the levels that can be accepted with equanimity by other powers” (p. 4), this will evoke both symmetric and asymmetric adversarial reactions from its neighbours and global peers. Moreover, Luttwak considers that China’s strategic dilemma arises from China’s strategic culture with a label of “autism”. Based on some examples illustrating China’s assertiveness, China’s “autism” interprets foreign motives in exclusively terms. In Luttwak’s words, geo-economic containment might be recommended to slow China’s economic growth and maintain a proper balance of power, which could reduce China’s “growth to 4-5 per cent per year from the present 9 per cent or so” (p. 47).
As Luttwak predicts, China could not get out of the strategic dilemma easily, unless there are “radical changes inside or outside China” (p. 4). First, a full democratization could promote China to pursue other strategic aims, which maximizes ‘the happiness of the population rather than their own power’ (p. 270). Second, the emergence of more critical threats in the future, which will probably promote the neighbouring countries or global peers to consider China as an ally, not a threat. Third, in contrast to China’s neighbours and global peers, China’s relative power “passes beyond the relevant tipping point” (p. 258).

As far as I can see, though this book develops a unique perspective of its own, some arguments and conclusions may be open to discussion. First, Luttwak’s historical narratives on China’s grand strategy are questionable to some degree, when he demonstrates “China’s failure at the level of grand strategy” (p. 69). For instance, Luttwak highlights the negative aspects of “autism” strategic culture and the detectable residues of Sun Tzu’s *The Art of War*. However, this argument could not provide tenable explanations to China’s significant strategic achievements in the past decades. If “autism” is synonymous of China’s strategic culture, how could China maintain a peaceful environment with her neighbours after the Cold War? How could China become a permanent member of the UN Security Council?

Second, Luttwak insists that China’s altitudes in some critical issues (e.g. China’s declaring the South China Sea to be a core interest) are the important evidences of China’s turning to more assertive altitude. Luttwak’s argument seems to exclude any other possibility. For example, as Alastair Johnston points out, it is possible for a state to be newly assertive on some limited range of issues while leaving other major policies unchanged (Johnston, 2013; p. 46).

Third, Luttwak advocates that geo-economic containment is the “only remaining resistance” (p. 266) for the neighbours and global peers of China. However, he also confesses that “what the logic of strategy predicts is a geo-economic struggle, though it cannot predict its outcome” (p. 47). In addition, some neighbours and global peers of China do improve relationships with the United States, but this phenomenon does not necessarily mean the strategic intentions of establishing an “anti-China coalition”, which could also be interpreted as conducting balance of power between the United States and China.

As a controversial work on the rise of China, *The Rise of China vs. the Logic of Strategy* will definitely provoke more thoughts and debates in the coming future. It deserves more attention from academics, scholars, policy makers and students of international relations, U.S.-Sino relationships and strategic studies.
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