

BANKING ON EAST ASIAN INTEGRATION?

IMPLICATIONS OF GLOBAL FINANCIAL CRISIS ON REGIONALISM

BERNARD ONG¹

Abstract

This paper examines the impact of the current global financial crisis, sparked off by the collapse of the US banking sector last year, on integration efforts in East Asia. Following the first wave of regionalism brought about by the Asian financial crisis of 1997-8, it reviews the effects of the current crisis on the pace of regionalism in East Asia. Through the lens of a neorealist, this paper looks at how the present financial upheaval has influenced foreign policy calculations and behaviors of countries in relation to its impact on the momentum of East Asian regionalism. The central argument is that the current global crisis, whose effects on the world economy is second only to the Great Depression of the 1930s, will not be a catalyst to the integration process in the region. The conditions leading to the first rush of East Asia regionalism after the Asian financial crisis are not present in the current crisis. Rather than a second wave of regionalism as seen in the decade following the events of 1997-8, bilateralism is likely to take precedence over regionalism as East Asian countries' preferred modus operandi in responding to the accelerated rise of China precipitated by the present crisis.

Section I: Introduction

The current financial upheaval, which started with the collapse of the United States (US) banking sector in September 2008, has a deep impact on the global financial system. Economies across the world experienced severe strains to their banking industries causing some governments to nationalize their banks and put in place

¹ This paper is prepared for the Summer Institute on Asian Regional Integration, 3-8 August 2009, organized by the Global Institute for Asian Regional Integration (GIARI) under the Waseda University Global COE Program. The author would like to thank GIARI for the opportunity to present his findings and participate in the Summer Institute.

stimulus packages to reinvigorate their domestic markets. In a recent article to *Forbes Asia*, Singapore Minister Mentor Lee Kuan Yew shared his views that East Asian countries were the hardest hit in the current world crisis.² Former US Deputy Treasury Secretary Roger Altman wrote in *Foreign Affairs* that “the financial and economic crash of 2009, the worst in over 75 years, is a major geopolitical setback for the United States and Europe”.³ What started as a US banking problem has turned into a global crisis affecting all countries. Governments across the world from Asia-Pacific to Europe scrambled to assure markets that their banking structures were sound and not in danger of bankruptcies.

To deal with the unprecedented crash of the global financial system, some countries resorted to using what are perceived as anti-free trade instruments to protect and spur their domestic industries. Their actions appear to vindicate the common retort that economic crises impede regional integration due to the tendency of member countries to apply unilateral protectionist measures. US President Barack Obama, for example, had pushed for a “Buy American” clause in his economic stimulus package which required new infrastructure projects to use American-made manufactured materials.⁴ While the clause was eventually softened with a provision that constrained procurements to be aligned with US’ international trade obligations, several US cities and states were not bound by the rules of the World Trade Organization (WTO) and North American Free Trade Agreement (NAFTA).⁵ At the time of writing this paper, Canada has issued a statement promising retaliatory actions if the US does not withdraw the protectionist article. In another tit-for-tat response, Beijing also announced a “Buy China” policy in June 2009, mandating its government procurement to use only Chinese products or services unless they were not available within the country.⁶ In an exclusive interview with China Daily on 15 July 2009 during an official visit to

² Forbes Asia, “East Asians Hardest Hit in World Crisis” (8 June 2009).

³ Roger C. Altman, “The Great Crash, 2009: A Geopolitical Setback for the West”, *Foreign Affairs*, Vol. 88, Iss. (January/February 2009), 2-5.

⁴ Wall Street Journal, “Obama Risks Flap on ‘Buy American’” (4 February 2009).

⁵ New York Times, “The Peril of ‘Buy American’” (3 June 2009).

⁶ Financial Times, “‘Buy China’ Policy Set to Raise Tensions” (15 June 2009).

Beijing, US Commerce Secretary Gary Locke conceded that it would be difficult to find “the right balance between free trade and protecting domestic companies, especially in tough economic times”.⁷ These two episodes illustrate how even the world’s superpower and rising power had to turn their backs to the ethos of free trade in the face of a major economic downturn.

In Southeast Asia, some analysts have begun to cast doubts on the Association of Southeast Asian Nations’ (ASEAN) plan to create an ASEAN Economic Community (AEC) by 2015, which in better times, were already seen as an ambitious target to achieve.⁸ A case in point is Indonesia’s push for a “Buy Indonesia” programme which directs its civil servants to purchase only locally made products.⁹ Malaysian Prime Minister (PM) Najib Razak also announced at a mini-budget in March 2009 a doubling of the country’s foreign worker levy to encourage the hiring of locals.¹⁰ Such protectionist measures have led ASEAN Secretary-General Surin Pitsuwan to caution that protectionism will harm ASEAN’s integrated market plan.¹¹ Pitsuwan’s sentiment is echoed by Asian Development Bank (ADB) President Haruhiko Kuroda who acknowledged at a public lecture in Singapore on 22 June 2009 that we were “faced with the rise of protectionism in Asia-Pacific and all over the world”.¹² It should be highlighted here that the revival of protectionism cuts across both developing, as well as developed countries. In April 2009, World Bank (WB) President Robert Zoellick revealed that nine of the Group of 20 (G-20) nations were considering or had taken measures to restrict trade in the face of the current economic downturn.¹³ WTO Director-General (DG) Pascal Lamy also acknowledged at a General Council meeting in May 2009 that the global trading system would face added political strain as the economic crisis heightened

⁷ China Daily, “Let’s Get the Balance Right, Says Locke” (16 July 2009).

⁸ The Business Times, “Crisis Will Spur ASEAN Economic Integration” (24 February 2009).

⁹ The Jakarta Globe, “New Idea to Boost Economy” (27 February 2009).

¹⁰ The Star, “HR Minister Wants Doubling of Foreign Worker Levy Delayed” (25 March 2009).

¹¹ The Jakarta Post, “Global Crisis a Hurdle to Economic Integration” (27 February 2009).

¹² Haruhiko Kuroda’s reply during the Question & Answer Session, Public Lecture organized by the Institute of Southeast Asian Studies on “Asia’s Recovery from the Global Financial Crisis – What it Takes and What Could ADB do?” in Singapore (22 June 2009).

¹³ The Straits Times, “World Bank Leader Warns G-20 Not to Restrict Trade” (25 April 2009).

protectionist pressures.¹⁴

The evidence suggests a creeping disposition among members of both regional and international organizations to embark on unilateral solutions, which are detrimental to regional cooperation and integration efforts, in the present crisis. This paper aims to address the pertinent theme: Will the current global financial crisis present an opportunity or impediment towards East Asian regionalism?

Section II begins the discussion by taking stock of current literature on the effects of global crises on geopolitical and economic interactions. With the benefit of hindsight, the analysis looks into the implications of the Asian financial crisis of 1997-8 on the progress of East Asia regionalism. The findings show a broad consensus that the Asian financial crisis has hastened the pace of regionalism in East Asia with a slant towards ASEAN-centric regional forums.

Section III proposes a theoretical framework to examine the implications of the current crisis on regional cooperation in East Asia. It highlights the dearth of a system-level theory to appraise the impact of global crises on regionalism before surveying the effects of the current financial turmoil on regional cooperation through the lens of a neo-realist. The main thrust of the discussion is that global crises could narrow the disparity of capabilities among countries, and hasten the rise of new powers. The accelerated change in the distribution of capabilities among countries will influence a state's foreign policy calculations, including its decision on the forms of regional cooperation to take.

Section IV accounts for the shifting distribution of capabilities in the present crisis between the US and China. It addresses the pertinent question of how this defining event will impact on East Asian integration. The results suggest that the crisis has hurt the Americans more than the Chinese, and that current efforts by

¹⁴ The Business Times, "More in WTO Support an Early Doha Deal to Tackle Protectionism" (28 May 2009).

China to reduce its reliance on the US could be seen in the wider context of a more assertive China with greater foreign policy options. The section then highlights how the rest of East Asia, as secondary states, have responded to the accelerated rise of China, and how this would impact on the destiny of East Asian regionalism in the next decade.

This paper is primarily focused on studying the impact of the present global crisis on the integration of East Asia. Historically, developments of a worldwide consequence such as the 9-11 terror attacks have the ability to reshape the international geopolitical and economic landscape. Pollack makes a more definitive assertion that future regional strategic patterns will be driven by events.¹⁵ In the words of Jayasuriya, economic crises unsettle prevailing entrenched interests and regional arrangements while providing opportunities for new reformist coalitions to form.¹⁶ The findings of this paper suggest that the present crisis will not lead to a second wave of regionalism in East Asia as seen during the Asian financial crisis.

Section II: Literature Review

Notwithstanding the conspicuous shift towards protectionism in the current crisis as highlighted in Section I, there is another school of thought which purports that economic catastrophes could hasten regional cooperation. A 2007 Organization for Economic Cooperation and Development (OECD) report indicated that the Asian financial crisis of 1997-8 had acted as a trigger for enhanced financial cooperation in Asia, especially in the area of finance and Foreign Direct Investment (FDI).¹⁷ The underlying assumption is that countries understand the interdependence of their economies and that survival depends on their willingness

¹⁵ Jonathan D. Pollack, "The Asian Security Order" in David Shambaugh, ed., *Power Shift: China and Asia's New Dynamics* (California: University of California Press, 2005), 342-3.

¹⁶ Kanishka Jayasuriya, "Introduction: The Vicissitudes of Asian Regional Governance" in Kanishka Jayasuriya, ed., *Asian Regional Governance: Crisis and Change* (Abingdon, Oxon: Routledge, 2008), 3.

¹⁷ OECD Report, "Fostering Regional Integration: Peer Review in Southeast Asia" (May 2007), 3.

to work as a regional grouping to overcome the economic downturn. This group of scholars maintains that crises play a “catalytic role in developing a sense of common identity, particularly in the image of a region in adversity besieged by outsiders”.¹⁸ In support of their case, they explain that the economic upheaval of 1997-8 has propelled ASEAN countries’ pursuit for solutions to reduce the effects of the financial disruption, as well as their subsequent alignments with China, Japan and South Korea through the ASEAN Plus Three platform.¹⁹ The most important outcome and often cited achievement of the region in the post-crisis period was the creation of the Chiang Mai Initiative (CMI) announced by the finance ministers of ASEAN Plus Three in May 2000. The Asian financial crisis was also seen as a stimulus which kick-started regional discussion on the ASEAN Bond Market Initiative (ABMI) and Asian Currency Unit (ACU), among others.

In addition to the concerted accomplishments by the region at the institutional level, there was also a noticeable spike in the number of Free Trade Agreements (FTAs) established in the post-crisis period. Urata, for example, points to the active formation of Regional Trade Agreements (RTAs) among Asian countries since the early-2000s, and concludes that the Asian financial crisis has led to an awareness of the need for regional cooperation such as a region-wide FTA to avoid another crisis and to promote economic growth.²⁰ Several analysts were also quick to highlight that the proliferation of RTAs during the post-crisis period was significant given that China, Japan and South Korea were not a party to an FTA up to the 1990s.²¹ By contrast, China expedited the negotiation and conclusion of the ASEAN-China FTA shortly after the Asian financial crisis, which was to be followed

¹⁸ Hidetaka Yoshimatsu, *The Political Economy of Regionalism in East Asia: Integrative Explanation for Dynamics and Challenges* (New York: Palgrave Macmillan, 2008), 16.

¹⁹ Yoshihiro Otsuji and Kunihiko Shinoda, “Evolution of Institutions and Policies for Economic Integration in East Asia: History and Prospects” in Masahisa Fujita, Satoru Kumagai and Koji Nishikimi, eds., *Economic Integration in East Asia: Perspectives from Spatial and Neoclassical Economics* (Cheltenham: Edward Elgar Publishing Limited, 2008), 112.

²⁰ Shujiro Urata, “Institutionalization of Regional Economic Integration in East Asia”, *GIARI Working Paper* (December 2008), 22.

²¹ Motoshige Itoh, “The Integration Process in East Asia: Japan’s Experience and Policy Agenda” in Duck-Koo Chung and Barry Eichengreen, eds., *Fostering Monetary & Financial Cooperation in East Asia* (Singapore: World Scientific Publishing, 2009), 147.

by the ASEAN-Japan and ASEAN-Korea FTAs.

A mention should be made here about China and Japan's considerations in the formation of the ASEAN Plus Three grouping. China's unequivocal support of an East Asian institution in the post-crisis period was expected given its interest to further enhance its prestige in the region after its initial loan offers to crisis-affected countries and resistance to devalue the yuan. Chinese assistance was seen as "free coals in cold weather" and heightened its influence in East Asia.²² On the other hand, Japan's decision was less straightforward because it had not supported Malaysia's suggestion for an East Asian Economic Caucus (EAEC) which excluded Japan's staunchest ally, the US, in 1992. Terada attributes Japan's policy shift to its realization that a consensus had developed that the time was ripe to create East Asian regionalism to tackle regional problems, and that critically the US was not opposed to the ASEAN Plus Three institution.²³

More significantly, observers like Dittmer underline that the events of 1997-8 have led to a shift in the focus of regional cooperation from wider Pacific Rim organizations such as the Asia-Pacific Economic Cooperation (APEC) to all Asian forums comprising the ASEAN Plus groupings and bilateral FTAs.²⁴ That ASEAN countries have moved closer to their Northeast Asian counterparts, especially with China was, in part, due to US' poor leadership during the financial meltdown. US' nonchalant response led to a widespread perception that the country could not be depended on during a crisis. There was a strong resentment among some East Asian countries against the "Washington Consensus" of rapid deregulation and privatization, which underpinned the International Monetary Fund (IMF) policy prescriptions for crisis-affected countries.²⁵ The conditions associated to the

²² Long Guoqiang, "China's Policy of Opening Up in the Decade After the Asian Financial Crisis" in Wang Mengkui, ed., *China in the Wake of Asia's Financial Crisis* (Oxon: Abingdon, Routledge, 2009), 70.

²³ Takashi Terada, "Japan and the Evolution of Asian Regionalism", *GIARI Working Paper* (December 2007), 17.

²⁴ Lowell Dittmer, "The Asian Financial Crisis and the Asian Development State", *Asian Survey*, Vol. 47, Iss. 6 (Berkeley: University of California Press, 2007), 830-3.

²⁵ Yoshimatsu, *Japan and East Asia in Transition*, 140.

financial rescue packages laid down by the US-backed IMF were deemed to be too severe, especially in Indonesia. Furthermore, US' veto of Japan's proposal for an Asian Monetary Fund (AMF) on grounds that it would undermine IMF's efforts and allow wayward governments to postpone reforms was interpreted as an attempt by the US to maintain its hegemony in Asia. The lesson for East Asian countries was that they could not count on outside assistance during a crisis.

The current body of literature reflects a general consensus that the economic collapse of several East Asian economies during the crisis of 1997-8 paved the way for regional cooperation. The study also suggests that the region has resorted to self-help in the absence of a strong leadership from the US. The post-crisis period also witnessed ASEAN becoming the centerpiece of an accelerated East Asian regionalism through the ASEAN Plus Three framework. East Asian countries have come to the realization that regional cooperation insulates them from global shocks and reduces their economic dependency on the US, as well as Europe.

Turning to the current crisis, a few emerging studies suggest that the ongoing financial turmoil has reshaped the international financial and economic order. Henning, for example, argues that the US banking catastrophe presents an opportunity for Asia to bolster financial cooperation by enhancing regional surveillance and policy dialogue.²⁶ Among the first initiatives proposed, ADB President Kuroda mooted the idea of an Asian Financial Stability Dialogue (AFSD) to strengthen regional ties among finance ministers, central bankers and other supervisory agencies.²⁷ The AFSD will enable Asian governments to develop a coordinated plan of action to monitor potential vulnerabilities and internalize regional spillovers. In addition, an *Economist* report highlights that China is using

²⁶ C. Randall Henning, "US Financial Crisis, Spillover to Asia and Opportunities for Asian Regionalism", paper presented to the 22nd Asia Pacific Roundtable in Kuala Lumpur, Malaysia (3-5 June 2008), 1-10.

²⁷ Haruhiko Kuroda, "High-Level Conference on Financial Crisis, Global Economic Governance, and Development", Keynote Address in New Delhi, India (6 February 2009).

the current financial upheaval to boost its strategic influence in Asia.²⁸ At the time of writing this paper, available analyses on the present crisis thus far have tended to focus on the causes of the US banking crisis and how it has led to the current global financial meltdown rather than looking at how such external shocks could influence states' foreign policy considerations on regional cooperation, which is what this paper has set out to achieve. The remaining discussion therefore aims to address the following question: In light of the present worldwide economic crunch, will East Asia experience a second wave of regionalism in the next decade as seen after the Asian financial crisis?

Section III: Theoretical Framework

Current research on global crises offers few theoretical explanations on how a catastrophic economic event can influence the momentum of regionalism in East Asia. Calder proposes a critical juncture framework to account for how the Asian financial crisis has called into question the existing geopolitical arrangement, and led to an urgent stimulus for change among East Asian countries.²⁹ Critical junctures, as defined by Calder, are historical decision points at which there are clear alternative paths to the future.³⁰ Broadly summarized, crises galvanize national governments in taking steps to forge closer economic cooperation.

On the other hand, Beeson describes the post-crisis collaborative phenomenon as "reactionary regionalism", which is defined as the direct result of regional initiatives designed to mediate and moderate external influences, in particular the US' policies in East Asia.³¹ According to Beeson, a key motivating factor was the possibility that regional institutions might have the potential to provide collective

²⁸ The Economist, "A Time for Muscle-Flexing" (19 March 2009).

²⁹ Kent E. Calder, "Critical Junctures and Northeast Asian Regionalism", in Kent E. Calder and Francis Fukuyama, eds., *East Asian Multilateralism: Prospects for Regional Stability* (Baltimore: John Hopkins University Press, 2008), 16-25.

³⁰ Ibid.

³¹ Mark Beeson, "ASEAN Plus Three and the Rise of Reactionary Regionalism", *Contemporary Southeast Asia*, Vol. 24, No.2 (Singapore: Institute of Southeast Asian Studies, August 2003), 251-68.

regional responses to external challenges.³² This framework is similar to Wade's assertion that post-crisis policy responses could only be understood by examining the role played by the US as the world's leading international financial actor.³³ The US has been instrumental in inducing East Asian governments to undertake rapid financial opening and liberalization without which market integration in the region would not have been possible.³⁴ Wade's proposition is corroborated by Ito's second-level research on the behaviors of firms in the post-Asian financial crisis period. Ito's findings suggest that market-led integration of production and investment was responsible for the process of East Asian regionalism.³⁵ Diverse economic conditions in terms of wages and technology in the post-crisis period made it possible for firms in East Asia to enjoy the advantages of an extensive cross-border division of labor, which in turn motivated firms to lobby governments to seek lower trade barriers. Urata also characterizes the nature of regional economic integration in this region as market-driven rather than institution-driven regionalization by explaining that it is trade and FDI liberalization policies, which prompted integration in East Asia rather than the formation of RTAs.³⁶ This view is shared by Otsuji and Shinoda who contend that regionalism in East Asia is driven largely by market forces in the form of substantial FDIs by the Chinese, Koreans and Japanese, as opposed to political will.³⁷

What could be inferred from Beeson and Wade's hypothesis is that East Asian regionalism during the post-crisis period was made possible only because of pressures applied by the US and its financial intermediaries such as the IMF and WB. On balance, however, critical junctures and reactionary regionalism could not explain why RTAs and ASEAN Plus Three took the center stage of East Asian

³² Mark Beeson, *Regionalism & Globalization in East Asia: Politics, Security and Economic Development* (New York: Palgrave Macmillan, 2007), 12.

³³ Robert Wade, "The US Role in the Long Asian Crisis of 1990-2000" in Arvid John Lukauskas and Francisco L. Rivera-Batiz, eds., *The Political Economy of the East Asian Crisis and its Aftermath* (Massachusetts: Edward Elgar Publishing Limited, 2001), 196-7.

³⁴ *Ibid.*, 221.

³⁵ Itoh, "The Integration Process in East Asia: Japan's Experience and Policy Agenda", 153.

³⁶ Urata, "Institutionalization of Regional Economic Integration in East Asia", 2.

³⁷ Otsuji and Shinoda, "Evolution of Institutions and Policies for Economic Integration in East Asia: History and Prospects", 108.

regionalism over other forums in the aftermath of the Asian financial crisis. The current body of literature on crises does not adequately explain how an economic catastrophe influences the degree of interaction among states and why they turn towards or away from cooperation in times of crisis. Will the decade following the current crisis lead to a second wave of East Asian regionalism as it did after the Asian crisis of 1997-8? If so, will the post-crisis architecture of East Asian cooperation follow that of the post-Asian financial crisis, viz., favoring and accelerating the ASEAN Plus Three cooperation, in particular the ASEAN-China relationship, over other forums such as APEC?

The theoretical basis of this paper is founded on Waltz's neo-realist interpretation of international relations. Using a system theory, Waltz defines international politics as a structure comprising of units with three characteristics, namely, (i) an ordering principle which is anarchy (all states are equal); (ii) each unit performs similar functions; and (iii) changes in distribution of capabilities across units affect the structure of the system.³⁸ Waltz's theory needs no introduction here, except a brief elaboration on the third principle, which forms the thrust of this paper. According to Waltz, "the structure of a system changes with changes in the distribution of capabilities across the system's units. And changes in structure affect expectations about how the units of the system will behave and about the outcomes their interactions will produce."³⁹

This paper argues that global crises such as the current global financial turmoil have the capacity to reorganize the distribution of capabilities among states, in particular those of the US vis-à-vis China. The change of distribution of capabilities, whether perceived or actual, will affect foreign policy calculations of secondary states, which will in turn influence their behaviors and interactions. That China is a rising power which will challenge the US' supremacy is not a new observation, but the key theme here is that global crises have the ability to expedite the rise of a

³⁸ Kenneth Waltz, *Theory of International Politics* (Reading, Massachusetts: Addison-Wesley, 1979), 101-2.

³⁹ *Ibid.*, 97.

superpower-to-be. The hastened structural change at the system-level will affect how East Asian countries behave and interact with one another.

This hypothesis, if true, will lead to two observable state behaviors. First, rising powers will seize the opportunity of a global crisis to reduce their dependency on the superpower in an attempt to move away from a unipolar world. Second, secondary states will exploit these external shocks to maximize their interests as Waltz argues “secondary states, if they are free to choose, flock to the weaker side; for it is the stronger side that threatens them”.⁴⁰

At first glance, it would seem counter-intuitive to suggest that Waltz’s theory of international relations offers an explanation to the pace of regionalism in East Asia in the present crisis, and to apply a political framework to an economic event. However, this paper takes a strong assumption that economic might equates to power as many scholars have likewise purported. Ikenberry, for example, notes that state power today is ultimately based on sustained economic growth. Cox also asserts that the economy is the foundation stone of all viable empires.⁴¹ While the US could wage wars in Middle East without the endorsement of the United Nations (UN) following the 9-11 attacks in the security realm given its military might, its economy was too intertwined with the rest of the world, especially China, for the Americans to undertake any unilateral economic actions. Moore therefore concludes that US’ policy options are increasingly constrained by the interdependence of its ties to East Asia, especially in economic affairs.⁴² Section IV illustrates the drifting capabilities of US vis-à-vis China and suggests that the latter has taken bolder steps to move away from a unipolar world. It then addresses the pertinent question of how the rest of East Asia has responded to a more assertive China in the present crisis in relation to the likelihood of a second wave of East Asian regionalism.

⁴⁰ Ibid., 127.

⁴¹ Michael Cox, “Is the United States in Decline – Again?”, *International Affairs*, Vol. 83, Iss. 4 (2007), 651.

⁴² Thomas G. Moore, “The Changing Face of American Power” in Nicholas Thomas, ed., *Governance and Regionalism in Asia* (Abingdon, Oxon: Routledge, 2009), 215-6.

Section IV: Accelerated Shift in Distribution of Capabilities

The late-Chinese leader, Deng Xiaoping, said in the early-1990s that China should “hide its capabilities and bide its time”.⁴³ This section describes how the US banking crisis has reconfigured the calculations of East Asian countries on the capabilities of the West, especially the US vis-à-vis China. It maintains that while China has been hurt by the present crisis, its economic and financial power has been strengthened relative to those of the West, in particular the US. No longer content with hiding its capabilities in the present crisis, China has assumed a more assertive posture in its dealings with the US and the wider East Asian region.

The crisis hurts the US much more than China

The US banking crisis has been described as “the most destructive 30 years of finance in world history”.⁴⁴ The IMF attributed US\$2.7 of the US\$4.1 trillion global losses in this crisis to the US.⁴⁵ Countries which depended on exporting to the US market were the most affected. For instance, the *Wall Street Journal* reported that the economies of the three largest trading partners of the US, namely, Japan, Germany and Mexico, plummeted since the onset of the global recession.⁴⁶ At the macro-level, the WB highlighted that the OECD economies, which accounted for 71 percent of the world’s Gross Domestic Product (GDP) in 2007, had shrunk by 4.2 percent in the first quarter of 2009 from a year earlier.⁴⁷ The US and Japan alone contributed to 0.9 and 1 percent of that decline respectively. By contrast, the WB raised the GDP forecast for China from 6.6 to 7.2 percent in 2009, and expected the Chinese economy to grow 7.7 percent in 2010.⁴⁸ When asked for their

⁴³ Bloomberg, “China’s Deng Dictum on Korea-to-Climate Dangers Imperiling G20” (20 April 2009).

⁴⁴ The Japan Times, “Subprime Crisis Was Unleashed by Bank-shielding Policymakers” (25 May 2009).

⁴⁵ The Financial Times, “IMF Put Financial Losses at \$4,1000 billion” (21 April 2009).

⁴⁶ Wall Street Journal, “World Economies Plummet” (21 May 2009).

⁴⁷ International Herald Tribune, “Leading Economies Report a Period of Record Decline” (25 May 2009).

⁴⁸ Financial Times, “World Bank Raises China GDP Forecast” (18 June 2009).

estimates of China's GDP in 2009 at an interview with McKinsey & Company in May 2009, four leading Chinese economists projected the Chinese economy as growing within the range of 7 to 9 percent in 2009, representing only a slight decline from its average of 9.7 to 9.8 percent in the past 30 years.⁴⁹ True to their forecasts, official data released by the PRC National Bureau of Statistic on 16 July 2009 confirmed that the Chinese economy grew 7.9 percent in the second quarter of 2009, which sets the country on target to achieve at least an 8 percent GDP growth for the year.⁵⁰ The impressive comeback posted by China less than a year into the crisis drew a prompt admission by a Merrill Lynch economist that "China's recovery is real, strong and sustainable".⁵¹ Summing up the impact of the banking crisis, Nobel Prize-winning economist Paul Krugman said that the US "risks a Japan-style lost decade of growth".⁵² With the US dollar in steep decline and the US financial system in crisis, most economists agree that US' financial prowess will wane over time.

At the micro-level, US multinational companies, which at one time were considered prospective challengers to usurp the traditional role of the state, such as American International Group (AIG), Lehman Brothers, General Motors (GM) and the likes, collapsed one after another like a deck of cards. The implication and reputational damage to the US cannot be understated. Bank of America (BoA), for example, was forced to sell its stake of China Construction Bank (CCB) in January 2008 and again in May 2009 to boost its own capitalization, a move which reduced its holding of the prominent Chinese bank from 30 to 11 percent.⁵³ Likewise, Citigroup had to sell off its holdings of Nikko, Japan's top three securities groups, less than three years after gaining a foothold in the Japanese market.⁵⁴ In a ranking of the world's best banks, the *Economist* assesses that the Chinese banks now dominate the

⁴⁹ McKinsey Global Institute, "Is China Recession Proof", *The McKinsey Quarterly* (May 2009).

⁵⁰ China Daily, "China's GDP Grows at 7.9% in Q2" (16 July 2009).

⁵¹ The Straits Times, "Domestic Demand Offsets Fall in Exports" (17 July 2009).

⁵² Reuters, "US Risks 'Lost Decade' Due to Half-Steps: Krugman" (11 May 2009).

⁵³ Xinhua, "China Construction Bank Downplays Bank of America Sale" (14 May 2009).

⁵⁴ The Japan Times, "Now Nikko Citigroup To Be Sold" (14 April 2009).

standing by market capitalization.⁵⁵ Outside of the finance sector, a July 2009 Fortune report also named 43 Chinese companies in its list of the world's 500 largest companies for the first time, registering a sharp increase from only 8 Chinese companies a decade ago.⁵⁶ While there were still 140 US companies on the list, 2008 marked the worst year in the history for US' largest companies with Wal-Mart also displaced from its pole position by a non-US company for the first time. Furthermore, as the list was based on the operating revenue of companies in 2008, it is expected that the ranking next year will show a further weakening of the US' economic prowess when the full force of the crisis on the US' companies in 2009 is factored in. A *Bloomberg* report in July 2009 affirmed that the Chinese stock market might surpass the US' as the world's largest by value within three years.⁵⁷

Both the micro and macro examples reinforce the point that the current financial turmoil has a disproportionate impact on the capabilities of the US vis-à-vis China. China is well-placed to ride out the crisis, which has, in turn, expanded its foreign policy options. By contrast, the economic and ensuing reputational damage to the US, as well as the collapse of its once powerful commercial enterprises are not to be taken lightly. McKinsey & Company surmises that US' role in the world economy, and its leadership of capitalism and democracy, as well as moral authority, have been severely weakened.⁵⁸ The US itself recognizes its dwindled position relative to the Chinese, and the shifting distribution of their capabilities in the current crisis. During an official visit to Beijing in June 2009, US Treasury Secretary Timothy Geithner conceded that "China is playing a very important stabilizing role in the international financial system".⁵⁹ But how exactly have the Chinese responded to their accentuated dominance?

⁵⁵ The Economist, "The World's Best Bank: A Short List" (23 May 2009).

⁵⁶ Xinhua, "43 Chinese Companies Join the Ranks of the Fortune 500" (10 July 2009).

⁵⁷ Bloomberg, "China 'to Overtake Wall Street in 3 Years'" (18 July 2009).

⁵⁸ Allen P. Webb, "Weighing the US Government's Response to the Crisis: A Dialogue" *The McKinsey Quarterly* (June 2009).

⁵⁹ Wall Street Journal, "Geithner Says Beijing Has Confidence in US" (3 June 2009).

China is seizing the opportunity to reduce its reliance on the US

According to Waltz, a change in the distribution of capabilities across the system's units changes the structure of the system. As the international structure alters, so does the extent of interdependence."⁶⁰ If Waltz's hypothesis holds true, we will observe China attempting to break away from the status quo by seeking measures to reduce its dependence on the US and exert greater international influence.

Waltz considers two or more countries as "interdependent if the costs of breaking their relations or of reducing their exchanges are about equal for each of them."⁶¹ This definition aptly describes the current state of US-China relationship. The Chinese State Administration of Foreign Exchange (SAFE), which is responsible for investing China's US\$2.13 trillion in currency reserves (as of 15 July 2009), conceded that the financial crisis had "struck a heavy blow to the international prestige of the dollar".⁶² Unfortunately for China, approximately 70 percent of its reserves are held in US dollar-dominated assets.⁶³ The Chinese are in a Catch-22 situation because selling away the US-dominated assets will further depress their overall market value and hurt the Chinese even more. In a revelation of the Chinese growing concern with the security of its US assets, PM Wen Jiabao conceded that the Chinese had lent a massive amount of capital to the US and called on the US to guarantee the safety of China's assets.⁶⁴ The sudden flurry of Chinese anxieties following the onset of the US banking crisis compelled Secretary Geithner to give the assurance that "Chinese assets [in US dollar-denominated investments] are very safe" in an address to Peking University.⁶⁵

Yet the Chinese have taken steps in the last few months to reduce its reliance on the US dollar. According to Yu Yongding, Head of Chinese Academy of Social

⁶⁰ Kenneth Waltz, *Theory of International Politics*, 144.

⁶¹ *Ibid.*, 143.

⁶² The Business Times, "Geithner to Reassure China Over its US Debt Investments" (29 May 2009).

⁶³ The Business Times, "Where Did All the Yuan Go?" (29 May 2009).

⁶⁴ New York Times, "China's Leader Says He is 'Worried' Over US Treasuries" (13 March 2009).

⁶⁵ Reuters, "Geithner Tells China Its Dollar Assets Are Safe" (1 June 2009).

Sciences International Economics and Politics Research Centre, China has done this in three ways, namely, stimulating domestic demand, diversifying funds from US dollar-dominated assets and making sensible adjustments to the structure of its US dollar-denominated debt.⁶⁶ The Chinese government has unveiled a 4 trillion yuan or US\$586 billion package to stimulate the domestic economy, in addition to currency swaps with various countries amounting to US\$95 billion which will enable its exports to be settled in yuan. In April 2009, the Chinese State Council also announced that the yuan could be used in overseas trade settlement in five Chinese cities following a trial run with Hong Kong, Macau and ASEAN in December 2008.⁶⁷ After the first successful completion of cross-border trade deals amounting to 14.38 million yuan by three Shanghai companies in July 2009, many companies in Singapore, Indonesia and Malaysia have shown great interest to switch to using the yuan in their trade.⁶⁸ These post-crisis measures were clearly aimed at reducing the Chinese reliance on the US dollar as its trading currency.

Furthermore, China had been vocal in making a strong pitch for the internationalization of the yuan in the past six months. Pushing for the replacement of the US dollar as the world reserve currency is a significant proposition by the Chinese. Traditionally, empires that hold the global reserve currency are also net foreign creditors and net lenders.⁶⁹ In a press release issued by Bank of China (BoC) in March 2009, Governor Zhou Xiaochuan attributed the outbreak of the crisis and its spillover to the entire world to the “inherent vulnerabilities and systemic risks in the existing international money system”.⁷⁰ Zhou was referring to China’s dependence on the US dollar as the world reserve currency. Calling for reforms to the international monetary system, he further proposed for a super-sovereign reserve currency to reduce the risks of a future crisis and enhance crisis management capability.⁷¹

⁶⁶ The Business Times, “Where Did All the Yuan Go?” (29 May 2009).

⁶⁷ China Daily, “New Move Takes Yuan Closer to Global Status” (20 April 2009).

⁶⁸ China Daily, “Yuan Trade Pilot Scheme Kicked Off” (7 July 2009).

⁶⁹ New York Times, “The Almighty Renminbi?” (13 May 2009).

⁷⁰ Xinhua, “Reform the International Monetary System” (26 March 2009).

⁷¹ Ibid.

It should be mentioned here that many experts agree that it will take a long time for the yuan to be used as a global benchmark, especially since it is difficult to buy and sell yuan outside of the country. China recognizes this and is realistic about its ability to reduce its reliance on the US dollar in the near term. Shortly after PM Wen and Governor Zhou's comments on the stability of the US dollar, the PRC Ministry of Foreign Affairs reiterated that "the US dollar is still the most important and major reserve currency of the day" and that "the situation will continue many years to come".⁷² In a speech made on behalf of Chinese President Hu Jintao to the Group of Eight (G-8) in Italy on 9 July 2009, State Councilor Dai Bingguo pressed for reforms to the global financial system and urged members to maintain the stability of major international reserve currencies, but stopped short of calling for the replacement of the US dollar.⁷³ Evidently, the Chinese government is avoiding a head-on collision with the Obama Administration, but their overtures, as seen through the flexing of their economic muscles and heightened lobbying of governments in the present crisis, reflect a more assertive China setting the stage for a greater role in world politics. This issue is likely to be raised again at the inaugural US-China Strategic and Economic Dialogue when Secretary of State Hillary Clinton and Secretary Geithner meet with their respective Chinese Co-Chairs, State Councilor Dai and Vice Premier Wang Qishan in Washington from 27-28 July 2009.⁷⁴

The Chinese government is also making use of the current crisis to augment the country's capabilities and search for new opportunities outside of the US through its Sovereign Wealth Funds (SWF). At the Boao Forum for Asia in April 2009, Luo Jiwei, Head of China Investment Corp (the main vehicle of Chinese SWF), disclosed that he was considering investing in Europe again now that the "European officials have been humbled by the global financial crisis."⁷⁵ Through its

⁷² China Daily, "China: US Dollar to Remain Dominance for Years" (6 July 2009).

⁷³ Xinhua, "China Urges Actions to Reform Global Financial System" (9 July 2009).

⁷⁴ Wall Street Journal, "Obama to Visit China, Resume Dialogue" (2 April 2009).

⁷⁵ The Financial Times, "China Set to Invest Again in Europe" (19 April 2009).

central bank and SAFE, China has reportedly accumulated assets amounting to approximately US\$22.7 billion worth of shares in various British industries since the onset of the crisis in 2008.⁷⁶ It is noteworthy that this sum represents only a small portion of China's US\$2.13 trillion of foreign exchange holdings.

The disproportionate impact of the current financial crisis on the US and Chinese economies should therefore be seen in the broader context of a more assertive China which is utilizing the present crisis to reduce its dependency on the US in an attempt to move away from the unipolar world. The remaining section addresses the pertinent question on how the rest of the East Asian countries have responded to the accelerated change in distribution of capabilities between the US and China.

East Asian countries recognizing power shift and adjusting behaviors

If Waltz's theory holds true, we will observe Southeast Asian countries again moving closer to their Northeast Asian counterparts especially China, rather than bandwagoning with the US. Does this mean that a second wave of regionalism as witnessed in the post-Asian financial crisis period is in the cards for East Asia?

According to a mid-year UN report in 2009, the recovery of Chinese domestic demand is expected to enable East Asian economy to enjoy a relatively robust growth rate of 5.6 percent in 2010.⁷⁷ The latest field research undertaken by McKinsey & Company reveals that China will hold the world's fourth-largest concentration of wealthy people by 2015.⁷⁸ The writings of a powerful Chinese economy accentuated by the present crisis are on the wall. Southeast countries are beginning to realize the shifting distribution of capabilities between the US vis-à-vis other powers such as China and, to some extent, Japan. Consequently, the past nine months following the outbreak of the crisis saw several key ASEAN

⁷⁶ Michael Heng and Lim Tai Wei, *Destructive Creativity of Wall Street and the East Asian Response* (Singapore: World Scientific Publishing, 2009), 162-3.

⁷⁷ Xinhua, "China to Bolster East Asia Economy: UN Report" (28 May 2009).

⁷⁸ Yuval Atsmon and Vinay Dixit, "Understanding China's Wealthy" *The McKinsey Quarterly* (July 2009).

countries going all out to woo the Chinese on a bilateral basis.

Signaling their intention to end trade in US dollars, Chinese PM Wen and Malaysian PM Najib announced during the latter's working visit to China in June 2009 that Malaysia and China would be considering conducting their trade in Chinese yuan and Malaysia ringgit for the first time.⁷⁹ Burdekin explains that even if the yuan is not ready yet to take on a greater role in Asia at this juncture, the absence of other obvious contender within the region suggests that this is the most viable long term option.⁸⁰ Such comments mark the genesis of an East Asian awakening to the growing might of China accentuated by the present crisis. At the same meeting with PM Wen in Beijing, PM Najib even offered a commercial banking license to China's central bank on the condition that the Chinese would reciprocate by allowing Malaysia greater access in China's financial and banking sector.⁸¹ Malaysia's rejuvenated pursuit of the Chinese market on a bilateral modality is not at all surprising given that the country is China's largest trade partner among the ASEAN countries, with trade value amounting to US\$39.06 billion in 2008.⁸²

Likewise, Thailand is redoubling its efforts to deepen its economic relations with China. In the face of a domestic crisis with pro-Thaksin supporters, Thai PM Abhisit Vejjajiva went ahead with a state visit to China in June 2009, leading a 300-member strong contingent comprising of government officials and businessmen to Beijing. Both premiers officiated the signing of an agreement to formalize a five-year trade deal between China and Thailand. During the visit, PM Abhisit went as far as to extending to PM Wen an invitation for Chinese companies to participate in the infrastructure projects in Thailand made available by the Thai government's 1.4

⁷⁹ Wall Street Journal, "Malaysia, China Consider Ending Trade in Dollars" (4 June 2009).

⁸⁰ Richard C. K. Burdekin, *China's Monetary Challenges: Past Experiences and Future Prospects* (New York: Cambridge University Press, 2008), 226. Burdekin also observes that the yen has been declining in importance worldwide due to Japan's longstanding economic weakness.

⁸¹ Bernama, "Najib: China's Trip Was Fruitful" (5 June 2009).

⁸² Xinhua, "China Raises Four-Point Proposal on Tackling Financial Crisis with Malaysia" (3 June 2009).

trillion baht economic stimulus plan.⁸³ This is an unusual and unprecedented proposition by the Thais given that stimulus packages are mostly intended to spur domestic industries rather than overseas companies. In Singapore, the de-facto investment arm of the government, Temasek Holdings, divested its entire stake of BoA in the US at an estimated loss of US\$3 billion in the first quarter of 2009, and explained that it would like to “focus on global companies that aim to grow in Asia”.⁸⁴ It is telling that, in the same period, Temasek Holdings raised the value of its investment foray into the Chinese banking sector through the purchase of a bigger stake in CCB, which has become the world’s second-largest lender by market value.⁸⁵

The emerging evidence indicates that key members of ASEAN have attempted to deepen their bilateral relations with China in the current crisis, and cultivate the Chinese markets by using the government-to-government approach. Separately, the largest market of ASEAN, Indonesia is seeking closer ties with Japan. Following Japanese Finance Minister Kaoru Yosano’s offer for Japan to guarantee US\$5 billion of bonds sold by developing countries in Bali on 3 May 2009, Indonesia announced that its seven banks would auction US\$500 million of “samurai bonds” or yen-dominated notes with the support of Japan in yet another indication of the waning interest in the US dollar.⁸⁶ What is common in the examples presented thus far is that ASEAN countries are tending towards the use of bilateralism in responding to the hastened rise of China in the present crisis. Yung warns that East Asian regionalism is at risk of evolving into an isolated region integrated in a shallow form with China as the center.⁸⁷ Apart from the manifestation of a Southeast Asia’s penchant for bilateralism rather than regionalism in the present crisis, the issues to consider here are three-prong, namely, leadership in Northeast Asia, Chinese growing interest to cultivate other

⁸³ Bangkok Post “High Hopes Rise on China Trip” (25 June 2009).

⁸⁴ Financial Times, “Temasek Sells Entire Stake in Bank of America” (15 May 2009).

⁸⁵ Reuters, “China Construction Bank Says Temasek to Raise Stake” (30 March 2009).

⁸⁶ The Business Times, Indonesia Picks 7 Banks for Samurai Bond Sale” (28 May 2009).

⁸⁷ Yung Chul Park, *Economic Liberalization and Integration in East Asia* (New York: Oxford University Press, 2006), 244.

regions, and political uncertainties in East Asia.

First, China has stepped up its cultivation of the ASEAN countries with the aim to harness a stronger leadership role in the region. That ASEAN's FTAs with South Korea and Japan were realized much later than the ASEAN-China FTA reinforces the view that China is acutely aware of its increasing importance to the region and how they could use it to fulfill their leadership aspiration in East Asia. Shortly after the ASEAN Summit in Pattaya in April 2009, Chinese Ambassador to Indonesia Zhang Qiyue met with Secretary-General Pistorius to follow up on PM Wen's eight proposals on strengthening the ASEAN-China cooperation, including the signing of a US\$10 billion ASEAN-China Investment Agreement to promote infrastructure development in the region,⁸⁸ as well as the provision of US\$15 billion credit to ASEAN countries.⁸⁹ Explaining that the current global crisis is likely to spur further integration among Asian markets, Dominic Barton, Director of McKinsey's Shanghai Office, suggests that the current global financial problems provide the leadership in this region a unique opportunity to pull together.⁹⁰ However, what Barton has failed to point out critically is that leadership is not a given matter in East Asia.

The intense competition for regional leadership, especially in light of US' weakened position in the present crisis, will be a major impediment to the deepening of East Asia regionalism or creation of an East Asian FTA. Evidently, no FTAs involving the three Northeast Asian countries have been concluded. For example, in a bid to fob off recent calls by China to use the yuan as the world reserve currency, Japan counter-offered a 6 trillion yen loan to financially stricken Asia to entrench the yen as the region's currency for trade in May 2009.⁹¹ The offer, which came just a month after Governor Zhou's announcement, was on top of the 3.8 trillion yen Japan had committed to the revised Chiang Mai Initiative Multilateralization (CMIM),

⁸⁸ China Daily, "China's Proposals on Co-operation with ASEAN Appreciated" (1 June 2009).

⁸⁹ Xinhua, "China Rolls Out Aid Package for ASEAN" (12 April 2009).

⁹⁰ Dominic Barton, "Asia's Future and the Financial Crisis" *The McKinsey Quarterly* (December 2008).

⁹¹ Asahi Shimbun, "Tokyo Aims to Push Yen Over Yuan in Asia" (5 May 2009).

which ostensibly also matched the Chinese obligation. The unprecedented push by Japan for Asian countries to take up yen-dominated loans is a testament to what Urata describes as an intense rivalry among East Asian countries, especially China and Japan in a race to assume a leadership role in the region.⁹²

The rivalry could also be observed during the negotiation by finance ministers of the ASEAN Plus Three countries on the components of the CMIM which aimed to pool together regional foreign reserves amounting to US\$120 billion by the end of 2009.⁹³ While China, Japan and South Korea agreed to contribute to 80 percent of the fund based on a 2:2:1 ratio, a high-ranking Thai official disclosed that negotiations appeared to be heading nowhere until the ASEAN countries asked Japan and China to contribute equal amounts to the CMIM funding.⁹⁴ On top of its CMIM commitments, Japan initiated a new currency swap agreement with Indonesia amounting to 1.5 trillion yen (US\$15.7 billion) in July 2009.⁹⁵ Unlike the CMIM agreement which will be carried out in US dollar, the Japan-Indonesia swap agreement is denominated in yen. These two examples again illustrate how China and Japan are jostling for regional leadership in East Asia. Furthermore, the stalemate is accentuated by what Pempel describes as a strong US resistance to any forms of regionalism in Northeast Asia and the wider East Asian region.

Second, the crisis has presented China with foreign policy options beyond East Asia. In the last decade, Amako has pertinently observed that Chinese policymakers have begun to move toward the idea of turning East Asia into a regional space that reflects China's intentions and interests.⁹⁶ Yet China is acutely aware that market integration can raise the vulnerability of the host economy. There will therefore be an increasing bias by the Chinese government towards a diversification of trading partners and export destinations. For example, China has

⁹² Urata, "Institutionalization of Regional Economic Integration in East Asia", 22.

⁹³ Xinhua, "Regional Cooperation Vital to Asia's Recovery" (6 May 2009).

⁹⁴ Asahi Shimbun, "Tokyo Aims to Push Yen over Yuan in Asia".

⁹⁵ Jakarta Post, "Indonesia, Japan Ink Fresh 1.5 Trillion Yen Swap Deal" (7 July 2009).

⁹⁶ Satoshi Amako, "The Idea of New International Order China is Seeking and East Asia Community", *GIARI Working Paper* (December 2007), 6-7.

started to expand its basket of FTAs to include more non-East Asian countries. Since late-2008, China has conducted FTA talks with countries like Chile, Costa Rica, Norway and Pakistan, and concluded a FTA with Peru in April 2009.⁹⁷ Since the onset of the crisis, China has also signed a series of accords for future cooperation with Russia including in the areas of natural gas and coal during President Hu's state visit to Moscow in June 2009.⁹⁸ Chinese Foreign Minister reportedly told the incoming Indian Foreign Secretary Nirupama Rao that China was ready to work with India to promote bilateral relations.⁹⁹

It is worth a mention here that non-Asian countries are as eager to court the Chinese, especially after seeing how economies in the West were badly affected by the global financial crisis. The Chinese, in turn, are playing their cards right. Its Ministry of Commerce, for example, has assured the African continent that the world economic crunch will not affect China's aid to Africa. At the same time, the financial crisis has given China the opportunity to go global by securing strategic assets at fire-sale prices such as in the mining sector in South Africa.¹⁰⁰ Separately, President Hu and Brazilian President Lula da Silva issued a joint communiqué on 19 May 2009 to further promote trade and bilateral economic cooperation between Brazil and China, which had also replaced the US as Brazil's top trade partner in April 2009.¹⁰¹ After the issuance of the Brazil-China joint communiqué, Brazilian officials revealed that the governors of the two countries' central banks would be meeting soon to discussing replacing the US dollar with the yuan in their trade transactions.¹⁰² Finland and China also concluded a series of high-tech contracts worth US\$1 billion, and kick-started discussion for trade deals amounting to US\$2 billion during Chinese Vice-Premier Li Keqiang's visit to Helsinki in June 2009.¹⁰³ During a working visit to Beijing, Hungarian Foreign Minister Peter Balazs asserted to his Chinese counterpart that developing relations

⁹⁷ China Daily, "China Hopes FTAs Will Help Boost Exports" (15 May 2009).

⁹⁸ Bangkok Post, "China, Russia Ties Must Flourish in Crisis" (17 June 2009).

⁹⁹ Xinhua, "China Vows to Advance Bilateral Ties With India" (14 July 2009).

¹⁰⁰ Xinhua, "China's Investment Expansion in South Africa 'Only Beginning'" (15 July 2009).

¹⁰¹ People's Daily, "China, Brazil Pledge Closer Ties on Trade, Economy" (20 May 2009).

¹⁰² Financial Times, "China Bolsters Brazil Trade Ties" (19 May 2009).

¹⁰³ China Daily, "Finland, China in \$3 billion High-tech Deals" (26 June 2009).

with China was a priority for Hungary.¹⁰⁴ The evidence therefore suggests that the Chinese have accelerated its charm offensive in the present crisis from Africa and Scandinavia to emerging markets in Eastern Europe and Latin America. The coming months will attest to even more Chinese advances into the non-East Asian region.

Third, the initial postponement and last-minute cancellation of the 14th ASEAN Summit and 4th East Asia Summit in April 2009 when anti-government protestors stormed the meeting venue in Pattaya reflected the paramount of domestic stability in Southeast Asia for any effective regional collaboration to take place. It has been acknowledged that ASEAN's role in brokering East Asian cooperation is central to the first wave of regionalism after the Asian financial crisis. Mahbubani, in his new book, goes as far as to say that ASEAN's remarkable diplomatic achievement is to enable the "peaceful emergence of new Asian powers like Japan, China and South Korea".¹⁰⁵ At the time of writing this paper, PM Abhisit's Democrat Party is still locked in an intense political standoff with pro-Thaksin supporters. As the current ASEAN chair, Thailand's looming domestic crisis does not bode well for the Southeast Asian grouping. In Malaysia, the Barisan Nasional government is still picking up the pieces after its heavy loss of five Malaysian states to the opposition coalition led by Anwar Ibrahim during its General Elections last year. Despite incumbent Indonesian President Susilo Bambang Yudhoyono's successful re-election in July 2009, a round of jockeying for key cabinet posts could be expected in the run-up to the installation of a 23-party coalition government on 20 October 2009. Moreover, the new cabinet, led by President Susilo's Democrat Party, will have to face off with its longstanding ally Golkar which has now become the de-facto opposition party.¹⁰⁶ Presidential and legislative elections are also expected in the Philippines in mid-2010, during which President Gloria Arroyo will step down as the Filipino constitution prohibits an elected president from seeking a second term.

¹⁰⁴ Xinhua, "Developing Relations with China is Hungary's Priority" (4 July 2009).

¹⁰⁵ Kishore Mahbubani, *The New Asian Hemisphere: The Irresistible Shift of Global Power to the East* (New York: PublicAffairs, 2008), 83-85.

¹⁰⁶ It is possible that President Susilo may invite Golkar, whose chairman is the current Indonesian Vice-President, Jusuf Kalla, to join the coalition party.

Such domestic uncertainties, coupled with the age-long issue surrounding Myanmar which has again come to the fold of international attention in recent months with the trial of Aung San Suu Kyi on charges violating the terms of her house arrest, do not augur well for the next wave of regionalism.

Section V: Conclusion

The prophetic economist, Nouriel Roubini, who famously predicted the current banking crisis in 2006, suggested that the US recession would last for two years at an interview with Reuters in May 2009.¹⁰⁷ His forecast was substantiated by credit rating agency Standard & Poor's (S&P) estimation that the US banking crisis might end in 2013.¹⁰⁸ At first glance, the current crisis presents an excellent window of opportunity for East Asian countries to redouble their efforts in creating the next wave of regionalism as seen in the decade after the Asian financial crisis of the 1990s. However, given the findings of this study nine months into the present crisis, this paper is less than sanguine about the second wave of regionalism in the near term.

The conditions which led to the first wave of cooperation after the Asian financial crisis of 1997-8 no longer exist in the current crisis. Section II has shown that the need to create a regional institution to meet the challenges of the Asian financial crisis, as well as the widespread perception of an unhelpful US leadership, was largely responsible for East Asia's push towards greater regional cooperation during the Asian financial crisis. As summarized by Thomas, the subsequent five years saw an explosion of new regional meetings between officials and ministers from every sector, which created a stronger sense of community between countries in ASEAN Plus Three.¹⁰⁹ Such conditions are not present in the current crisis.

¹⁰⁷ Reuters, "Roubini Says US Economy May Dip Again Next Year" (28 May 2009).

¹⁰⁸ The Business Times, "US Banking Crisis May Last Until 2013" (15 May 2009).

¹⁰⁹ Nick Thomas, "Towards an East Asian Community: Implications of the EAVG Report" in Kanishka Jayasuriya, ed., *Asian Regional Governance: Crisis and Change* (New York: Routledge, 2004), 189.

The recurring theme of this paper is that the present crisis has accelerated changes to the distribution of capabilities between the US and China. Premised on Waltz's theory of international relations, the conceptual framework presented in Section III suggests that the recent US banking crisis has propelled the rise of China, conferring the country with wider foreign policy alternatives.

Section IV has demonstrated how the structural change at the system-level has caused ASEAN countries to intensify their efforts to seek closer ties with China through the bilateral track, as opposed to using the regional platform. As highlighted by Leifer, the balance of power in Asia is alive and well.¹¹⁰ In his recent book, Beeson makes a parallel case for the declining importance of the American economy to East Asia, arguing that China may come to be seen as a force for stability in the global economy while the US will be cast as a source of instability in the aftermath of the current financial crisis.¹¹¹ Likewise, China has geared up its efforts to diversify its trade links with non-East Asian countries in the present crisis. Even the US is cognizant of the rise of China and its implications. US State Secretary Clinton conceded that the US was "seeing particularly China come in right behind us, because countries get tired of talking to our bureaucracy and decide that they're going to cut a deal with someone else".¹¹² Adding to the preference for bilateralism displayed by ASEAN countries (and China) less than a year into the present crisis, competition for leadership in Northeast Asia and continued uncertainties in several ASEAN countries are not favorable conditions for the next wave of regionalism.

Despite the somewhat dismal findings on the likely pace of regionalism in this paper, there is a silver lining on the horizon which could substantially change the landscape of East Asian cooperation and warrant further research on. The next three years will see Singapore, Japan and the US taking turns to host the annual

¹¹⁰ Michael Leifer, "Truth about the Balance of Power" in Chin Kin Wah and Leo Suryadinata, eds., *Michael Leifer: Selected Works on Southeast Asia* (Singapore: ISEAS Publications, 2005), 152-4.

¹¹¹ Mark Beeson, *Institutions of the Asia-Pacific* (Abingdon, Oxon: Routledge, 2009), 81.

¹¹² The Straits Times, "Speed Up Aid or Lose Clout: Clinton" (25 April 2009).

APEC Leaders' Meeting. Evidently, Japan and Singapore are close allies of the US, and the latter has long been pushing for a regional arrangement that encompasses more countries in order that no large country may dominate any regional discussions. The APEC leaders, who last met in Peru at a time when the world was on the brink of a global financial meltdown in November 2008, had set a target of 18 months for the APEC economies to overcome the crisis. A year into the US banking disruption, the post-crisis talks at the next meeting in Singapore in November 2009 are expected to include a call for APEC economies to resist protectionism and deepen regional integration.¹¹³ Despite celebrating its 20th anniversary this year, APEC has regrettably been widely perceived as an institution that is on relative decline when compared with emerging forums such as the ASEAN Plus groupings. Astute leadership from the Obama Administration and coordinated maneuverings with its allies are critical to invoke the next wave of regionalism through a revitalized APEC.¹¹⁴

¹¹³ Channelnewsasia, "APEC Trade Ministers to Discuss Financial Crisis Recovery" (15 July 2009).

¹¹⁴ US' accession to the Treaty of Amity and Cooperation, a cornerstone of the ASEAN grouping largely ignored by the Bush Administration, at the 42nd ASEAN Ministerial Meeting in Phuket in mid-July 2009, as well as State Secretary Clinton's participation of the ensuing ASEAN Regional Forum, is a step in the right direction to create the next wave of regionalism.