

# China's Strategy for Free Trade Agreements: Political Battle in the Name of Trade

(Working draft. All Comments are welcome)

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Compared with Europe and America, East Asia is a latecomer in the new gold-rush of Free Trade Agreements (FTAs). In this process, China has played a significant role. This is not only due to the growing economic clout of China, but also because China has taken a conscious strategy to push for economic integration in the region. Thus, for the benefits of the countries in the region, it is very important to understand China's FTA strategy. This article starts with the evolving picture of China's FTA web, then discusses the key components of China's FTA strategy, and concludes by noting the implications of China's FTA strategy on the region and beyond.

## I. Overview of China's FTAs

While China adopted the export-oriented development model when it started the economic reform in late 70s, it did not contemplate the possibility of entering into FTAs until much later for the following reasons:

The first reason is the general hostile attitude towards FTAs. Throughout the 70s and 80s, there was little interest in the FTAs. It was only in the early 90s that countries around the world started to engage in FTAs seriously. Indeed, of the most important FTAs existing in the world today, such as the EU, NAFTA, MERCOSUR and ASEAN, most only took their current form in the 90s. In particular, Asian countries lags behind their European and American counterparts when it comes to FTAs. Thus, even if China were interested in FTAs then, it would have difficulty finding negotiating partners.

The second reason is the different trade structure of China. When China first started the economic

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reform, most of its exports went to developed countries such as the US, EC and Japan. As China's export volume was low, these countries provided sufficiently big markets and there was no need to look for export markets elsewhere. For various reasons, however, it is quite difficult for China to negotiate FTAs with these countries. As to the other countries, it did not make sense for China to try to negotiate FTAs with them either due to the low trade volume with them.

The third reason is the resource constraint. Since 1986, the top priority for China was resuming its contracting party status in the GATT. When this proved impossible with the establishment of the WTO in 1995, China tried to step up its accession talks so that it could join the WTO as a founding Member. With most of its resources devoted to the most complicated accession process in the history of the GATT and WTO, China did not have the luxury of engaging in RTA talks.

The fourth reason is the strategic choice. Even if China had extra capacity to explore possible RTA deals, it would not be good move for China to start RTA negotiations in tandem with its WTO accession negotiation. On the one hand, any interest in RTA would cast doubt on China's true commitment to the multilateral trading system and make Members more reluctant to negotiate with China at the multilateral level. On the other hand, any serious RTA negotiation would require China to table offers that go beyond what it is willing to offer at the multilateral level. As China was not a WTO Member yet, however, other WTO Members would almost certainly use China's RTA offers as a benchmark to measure its WTO commitments so as to minimize the possibility of diluting the benefits they might obtain under the WTO. Essentially, by entering into RTA negotiations, China could only make its WTO accession negotiations more difficult for itself.

Important changes came in the early 90s, however. First, China gradually lost the patience in the WTO accession process when faced with a series of setbacks, including first its failure to "resume" its contracting party status in the GATT, and then the unsuccessful attempt to join the newly-established WTO as a founding Member. Frustrated by the slow progress in Geneva, China started to look for opportunities elsewhere, including in FTAs. Second, with the emergence of regionalism in Latin America (Mercosur, 1991), Southeast Asia (AFTA, 1992) and North America (NAFTA, 1992) in addition to the further strengthening of European economic integration with the

formation of the European Union (Maastricht Treaty, 1992), China did not want to be left out of the new wave of regional integration. Third, with China's growing trade volume, it becomes increasingly harder for Chinese firms to find new markets. In this regard, FTAs becomes a useful tool.

Thus, in the mid-90s, China started to consider the possibility of entering into FTAs. This is evidenced in 1996 by the publication of the Ninth Five-Year Plan, which is the key blueprint for national economic and social development drafted by the State Council with the advice from the Central Committee of the Communist Party of China and adopted by the National People's Congress. According to the Plan, China shall "actively participate and develop regional economic cooperation", as well as "strengthen 'South-South Cooperation', and promote and develop ... the economic and trade cooperation with developing countries". The same Plan, however, also calls for China to "actively participate and defend the global multilateral trading system, develop both bilateral and multilateral trade, so that they can promote each other and the market can be diversified" (emphasis added). Such an equivocal attitude seems to indicate that China took a cautious approach on FTAs initially and tried to hedge its risks by giving equal emphasis on both multilateral and regional/bilateral initiatives. Nonetheless, this is still a very important first step in China's move towards FTAs.

Shortly after, China was presented with the first opportunity for real FTA negotiations when the Southeast Asian countries were hit by the East Asian Financial Crisis in mid-1997. Whatever its cause, one consequence of the crisis was that people have lo<sup>1</sup>st faith in global institutions such as the IMF and World Bank, which were allegedly responsible for the Crisis with their highly-intrusive policy suggestions. Thus, in his speech at the first China-ASEAN summit held in December 1997, President Jiang Zemin calls for the two sides to build a "Good Neighboring Partnership of Mutual Trust".<sup>2</sup> In November 2000, the two sides further agreed in another Summit to explore ways to further enhance integration and economic cooperation

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<sup>2</sup> The text of the speech is available at [http://news.xinhuanet.com/ziliao/2002-10/28/content\\_610547.htm](http://news.xinhuanet.com/ziliao/2002-10/28/content_610547.htm).

between the two regions, including the possibility of establishing a free trade area.<sup>3</sup> After the Summit, an ASEAN-China Expert Group on Economic Cooperation was established to conduct feasibility studies on an ASEAN-China FTA. In October 2001, the Expert Group issued its report and concluded that an FTA would be in the interests of both parties.<sup>4</sup> At the ASEAN-China Summit held a month later, the two sides decided to establish an ASEAN-China Free Trade Area (“ASEAN-China FTA”) within 10 years.<sup>5</sup> One year later, the Framework Agreement on Comprehensive Economic Co-Operation between ASEAN and the People’s Republic of China was signed, and this marked the start of the tariff-reduction process leading to the eventual elimination of tariffs among the two sides.<sup>6</sup>

For a long time, the ASEAN states have viewed China more as a threat than a potential partner. At first, the ASEAN states were concerned mainly with political and military threats from the north.<sup>7</sup> Indeed, one of the primary reasons for the formation of ASEAN in 1967 was to counter the spread of communism in the region.<sup>8</sup> With China’s emergence as one of the most competitive producers of many products in the world, ASEAN started to perceive China more as an economic threat. After all, there is remarkable similarity in their industrial structures: both specialize in labor-intensive products, and both have the US, EU and Japan as their major exporting markets.<sup>9</sup> To a large extent, China’s increase in its exports during the last two decades of the twentieth century was achieved at the expense of its neighbors in Southeast Asia. With China’s rise as a major exporter, it also started to suck FDI away from its neighbors to the south: as wage levels in China are much lower, it makes sense to invest in China rather than ASEAN states. While before 2001, ASEAN could still take comfort in the idea that China was largely excluded from the many benefits offered by the multilateral trading system, such as MFN, this advantage they enjoyed soon became history with China’s

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<sup>3</sup> Forging Closer ASEAN-China Economic Relations in The Twenty-First Century, A Report Submitted by the ASEAN-China Expert Group on Economic Cooperation, October 2001, at p.4, available at [http://www.aseansec.org/newdata/asean\\_chi.pdf](http://www.aseansec.org/newdata/asean_chi.pdf).

<sup>4</sup> *Id.*

<sup>5</sup> Premier Zhu Rongji Attended the Fifth ASEAN-China Leaders Summit and Gave Important Speech, Xinhua Net, 6 November 2001, available at [http://news.xinhuanet.com/world/2001-11/06/content\\_101950.htm](http://news.xinhuanet.com/world/2001-11/06/content_101950.htm).

<sup>6</sup> The full text of the Agreement is available at <http://www.aseansec.org/13196.htm>.

<sup>7</sup> The Three Ages of ASEAN, Lecture delivered by Rodolfo C. Severino, Secretary-General of ASEAN at the ARCO Forum of Public Affairs, Kennedy School of Government, Harvard University, 3 October 2002, available at <http://www.aseansec.org/12310.htm>.

<sup>8</sup> *Id.*

<sup>9</sup> Report at p.15.

accession to the WTO at the end of that year. With its foot into the global trade club, China can now enjoy more predictable access to its major export markets with much lower costs, and this means intensified competition against ASEAN.<sup>10</sup> Thus, China's call for an FTA at around the same time as its WTO accession is an offer too good to reject: on the one hand, the ASEAN states could not do much to stop China from replacing them in the major exporting markets; on the other hand, with the growth in the domestic market in China, an FTA deal with China, the first of its kind, could guarantee the ASEAN states a first-mover advantage in the largest emerging market in the whole world. The Financial Crisis of 1997 also taught ASEAN states important lessons: First, global institutions such as the IMF and World Bank are not panacea, and it is important to have regional cooperation mechanisms as contingency plans. With the growing importance of China as an economic power, however, any regional cooperation mechanism in this part of the world would not be effective without the participation of China. Indeed, China's decision to not devalue its currency was widely appreciated among ASEAN states as an important factor in helping them go through the period: anyway, should China decided to float the Yuan, the ASEAN states would face more fierce competitions from cheaper Chinese products and this could have greatly eviscerated their problems. While Japan is also an important partner in regional cooperation, Japan was having its own problems during the 90s. Thus, China has become the natural choice. Second, it is important to diversify both their export markets and investment sources. Along with the growth of its domestic market, China also developed an increasingly bigger appetite for overseas investment. For ASEAN states, investments from China is a good way to make sure that their economic well-beings is not tied-up with the economic performances of a few economies.

With the ASEAN-China FTA as a starting point, China has firmly embarked on the road towards RTA. The following years witnessed the signing of the two Closer Economic Partnership Arrangements with Hong Kong, China<sup>11</sup> (June 2003) and Macau, China<sup>12</sup>

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<sup>10</sup> *Id.* at p.24.

<sup>11</sup> The full text of the Arrangement is available at [http://www.tid.gov.hk/english/cepa/legaltext/cepa\\_legaltext.html](http://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html).

<sup>12</sup> The full text of the Arrangement is available at [http://www.economia.gov.mo/page/english/cepa\\_e.htm](http://www.economia.gov.mo/page/english/cepa_e.htm).

(October 2003), respectively, the FTAs with Chile<sup>13</sup> (November 2005), Pakistan (November 2006), New Zealand (April 2008), Singapore (October 2008), Peru (April 2009); the launch of FTA negotiations with Gulf Cooperation Council<sup>14</sup> (April 2005), Australia<sup>15</sup> (May 2005), Iceland<sup>16</sup> (April 2008), Norway<sup>17</sup> (September 2008), and Costa Rica<sup>18</sup> (January 2009); with the negotiations with South African Customs Union to be started soon<sup>19</sup>. Also, China have been quite eager in signing an FTA with India, while India has given China cold shoulders over concerns such as the lack of competitiveness of Indian firms<sup>20</sup>, the mismatch between the trade patterns<sup>21</sup> and industrial structures<sup>22</sup> of two economies, and security concerns<sup>23</sup>. That probably explains why, despite that the joint feasibility study report on FTA have been concluded more than two years ago,<sup>24</sup> there was still no signs that the actual negotiations will pick up any time soon. Last but certainly not least, China has reached an advanced stage in its joint feasibility study with Korea with five rounds of working group meetings concluded.<sup>25</sup>

With eight FTAs behind its belt and more to come, it is time now to review China's FTA negotiating approach. In the following sections, we will discuss the following key issues in

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<sup>13</sup> The full text of the Agreement is available at [http://www.direcon.cl/documentos/China2/tlc\\_chile\\_china\\_ing\\_junio\\_2006.pdf](http://www.direcon.cl/documentos/China2/tlc_chile_china_ing_junio_2006.pdf).

<sup>14</sup> See China Completed First Round of FTA Negotiations with Six Gulf States, available at <http://gjs.mofcom.gov.cn/aarticle/af/ak/200505/20050500088391.html>.

<sup>15</sup> Australia-China FTA Negotiations, Subscriber Update, 26 May 2005, available at [http://www.dfat.gov.au/geo/china/fta/050526\\_subscriber\\_update.html](http://www.dfat.gov.au/geo/china/fta/050526_subscriber_update.html).

<sup>16</sup> [http://fta.mofcom.gov.cn/article/iceland/200809/49\\_1.html](http://fta.mofcom.gov.cn/article/iceland/200809/49_1.html).

<sup>17</sup> [http://fta.mofcom.gov.cn/article/norway/200809/93\\_1.html](http://fta.mofcom.gov.cn/article/norway/200809/93_1.html).

<sup>18</sup> [http://fta.mofcom.gov.cn/article/costarica/200902/465\\_1.html](http://fta.mofcom.gov.cn/article/costarica/200902/465_1.html).

<sup>19</sup> [http://fta.mofcom.gov.cn/article/southafrica/200809/48\\_1.html](http://fta.mofcom.gov.cn/article/southafrica/200809/48_1.html).

<sup>20</sup> See P Vaidyanathan Iyer & Amiti Sen, India Yes to Bipa, no to FTA/RTA, Financial Express, April 11, 2005, available at [http://www.bilaterals.org/article.php?id\\_article=1636](http://www.bilaterals.org/article.php?id_article=1636).

<sup>21</sup> As one article argues, "[India's] exports to China are basically raw materials, ores and steel (accounting for roughly 57% of exports), while China's exports to India are primarily manufactured goods (like electric machinery, electronic and audio-video equipment). Since manufactured goods have a much higher level of duty compared to raw materials, free trade will mean we give away our advantage more than gaining from them. Besides, unless our exports become more diversified, trade will not be sustainable in the long term."

[http://www.bilaterals.org/article.php?id\\_article=1701](http://www.bilaterals.org/article.php?id_article=1701). See Anjan Joy, The Journey Has Begun, But It'll Take Long To Arrive, Financial Express, India, 20 April 2005, available at [http://www.bilaterals.org/article.php?id\\_article=1701](http://www.bilaterals.org/article.php?id_article=1701).

<sup>22</sup> As noted by one article, "[o]ver 50% of China's GDP comes from manufacturing and construction, over 30% from services and just under 15% from agriculture. ... In contrast, over half of India's GDP comes from services with industry and agriculture sharing the remaining less than 50% in roughly equal proportions. ... That's where the rub lies. For the Chinese, an FTA focused on trade in goods would enable them to best leverage their comparative advantage. For India, on the other hand, an agreement restricted to or focused on merely free movement of goods across borders would be one that gives Chinese manufacturers ready access to Indian markets without a corresponding benefit for India in its area of strength." See Shankar Raghuraman, Why An FTA Gives Us Cold Feet, Times of India, 9 April 2005, available at [http://www.bilaterals.org/article.php?id\\_article=1629](http://www.bilaterals.org/article.php?id_article=1629).

<sup>23</sup> See Monica Gupta, Trade Pact with China Stuck Over Security, Business Standard, India, 8 August 2006, available at [http://www.bilaterals.org/article.php?id\\_article=5455](http://www.bilaterals.org/article.php?id_article=5455).

<sup>24</sup> [http://fta.mofcom.gov.cn/article/india/200809/68\\_1.html](http://fta.mofcom.gov.cn/article/india/200809/68_1.html).

<sup>25</sup> [http://fta.mofcom.gov.cn/article/ftanews/200909/988\\_1.html](http://fta.mofcom.gov.cn/article/ftanews/200909/988_1.html).

China's FTA strategy: choice of FTA model, criterion for the selection of partner, and negotiating objectives.

## **II. Choice of FTA model**

If we look around in the world, the FTAs can be broadly divided into two models. One is the EU model, which includes both economic and political integration. The other is the NAFTA model, which focuses on economic integration only. Within the NAFTA model, again there are two different sub-categories. The first is the Economic Partnership Agreement (EPA) approach advocated by Japan, which seeks to conclude comprehensive agreements that include trade in goods, services, and sometimes even environment protection and intellectual property rights. The other approach is much narrower and focuses on trade in goods only.

China has chosen to take the narrower model. Normally, China would start with an agreement on trade in goods only and would only expand to trade in services and investment after the commitments on goods have been substantially implemented. Take the FTA with Pakistan, for example, while the liberalization of trade in goods dates back to the signing of Agreement on the Early Harvest Program in April 2005, the Agreement on Trade in Services was only signed in February 2009. Similarly, in the FTA with ASEAN, the agreement on trade in goods was signed in November 2004, while the agreement on services was only signed in January 2007. A reverse example is the FTA negotiation with Australia, which has languished for years partly due to the fact that Australia insists on dealing with services liberalization first while China wishes to proceed with the usual "goods and then services" order.

With regard to the issues which are not traditionally trade-related, such as environment protection, competition policy, and labor standard, China has been reluctant to include them as part of the FTA package. Recently, however, China has shown some willingness to include these issues as part of the FTA package. Nonetheless, in line with its cautious approach, China has largely chosen not to include these issues in the main agreement of the FTA, but preferred to address them in stand-alone side agreements or MOUs.

### III. The criteria for selection of negotiating partners

When we take a look at the list of countries/regions which have negotiated or are negotiating FTAs with China, it seems to be quite random. To start with, the top three trading partners of China, i.e., the EU, US and Japan, are not on the list. Furthermore, even when we expand the scope to include the top ten trade partners of China, only three, i.e., ASEAN, Singapore and Hong Kong, have concluded FTAs with China. Among the remaining seven countries/regions, only another two, i.e., Australia and Korea, have started or about to start negotiations with China. However, for one reason or another, these two negotiations are not going to proceed on a smooth basis. Among the other countries/regions which have concluded or are negotiating FTAs with China, many only have negligible trade volume.

One tentative conclusion that we can draw from the facts above is that trade volume doesn't seem to be an important factor for China in selecting its negotiating partners, otherwise we wouldn't have so few of the important trade partners in the list. How, then, does China decide which countries shall be graced with the honor of becoming a member of the coveted FTA club with China? In an interview done in May 2007, Vice Minister Yi Xiaozhun of MOFCOM suggested the following criterion: first, the country has good political and diplomatic relationship with China; second, the country has complementary economic structures and trade patterns with China; third, the country either has substantial domestic market or serves as an FTA hub in a particular region; fourth, the country shares common intentions on building FTAs with China.<sup>26</sup>

While these criterion combined seem to explain most of China's FTA activities so far, as the examination of these factors below reveals, some seems to have more importance than others:

First, political and diplomatic relationship seems to carry most weight, as almost all the countries do have good political and diplomatic relationship with China. Among them, Pakistan has been a

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<sup>26</sup> Interview with Yi Xiaozhun.

very close ally of China for a long time. As to the others, they have also generally maintained good relationship with China. For example, Chile is the first country to establish diplomatic relationship with China in South America.<sup>27</sup> Similarly, New Zealand was the first WTO Member to conclude the bilateral talk in China's accession process, the first developed country to recognize China's market economy status, as well as the first developed country to propose FTA negotiations with China.<sup>28</sup> As to Singapore, while it was rather late in establishing formal diplomatic relationship with China, its support to China came at a perfect timing – 1990 – when China faced one of the worst sanctions from developed countries around the world after its crackdown of student movements in June 1989. With regard to the other countries in ASEAN, most of them historically were not really on friendly terms with China. In recent years, however, their relationships with China have become increasingly warm as China tried to maintain peace and security in an area that it views as its geopolitical back-yard. The strongest case of political undertone can be found in the FTA negotiation with Costa Rica, which was formally kicked off only one year after the tiny Latin American country switched alliances to China by breaking up with Taiwan, its friend for nearly 60 years.<sup>29</sup>

Second, while economic and trade complementarities are important, they don't seem to be major factors. It is true that several of the partners do complement with China economically. For example, Singapore and Hong Kong are highly-competitive in services exports, while New Zealand, Chile and Peru, as Cairns Group members, are quite competitive in agricultural exports. Both services and agriculture are sectors that China is relatively un-competitive. On the other hand, several FTAs also compete with rather than complement with China. For example, most of the ASEAN countries actually share with China an industrial structure that relies heavily on export-oriented labor-intensive manufacturing sectors. Their exports are also mostly in electronics and textile products, similar to those from China.

Third, between domestic market size and hubbing effect, the latter seems to be more important. Measured by most standards, the domestic markets of many partners are rather small. On the other

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<sup>27</sup> [http://www.fmprc.gov.cn/chn/gxh/cgb/zcgmzysx/nmz/1206\\_11/1206x1/t8019.htm](http://www.fmprc.gov.cn/chn/gxh/cgb/zcgmzysx/nmz/1206_11/1206x1/t8019.htm).

<sup>28</sup> <http://gov.people.com.cn/GB/7093066.html>.

<sup>29</sup> <http://www.msnbc.msn.com/id/19080068/>.

hand, almost all of them are important FTA hubs. For example, Singapore has FTAs with a dozen countries, including the US, Japan, Korea and Australia; Chile is an associate Member of both the Mercosur and the Andean Community; Iceland and Norway are members of the European Free Trade Association (EFTA), which has free trade relationship with EU via the European Economic Area (EEA); while India and Pakistan are both Members of South Asian Association for Regional Cooperation (SAARC). By entering RTA with these partners, China could potentially tap into the bigger markets created by the RTA arrangements that are already in place. This is a highly cost-effective way of exploring new markets.

Fourth, the existence of common intention on forming FTAs seems to play little role. While such common intentions can be found in FTA negotiations with Pakistan, Chile and Peru, the other negotiations seem to have started from one-sided love initially. The FTA negotiations with Singapore and New Zealand seem to result from the heavy lobbying of these two countries respectively. As to the FTA negotiations with ASEAN and India, China have invested heavily by trying to court these countries during the initial phase. Of course, as the Chinese is not very good at saying no, even if an FTA is first proposed by another party, China generally will try to accommodate such request. This is in marked contrast to the approach taking by some other countries, especially the US and EU, where the selection of FTA partners seems to be mostly a one-way process.

#### **IV. Negotiating objectives**

What does China try to achieve with its growing list of concluded FTAs and those currently under negotiation? Has China managed to achieve the intended objectives? A review of China's growing FTA network reveals the following common features:

First, in terms of the geographical distribution of RTA partners, China has tried to strike a balance. So far, China has concluded FTAs, or entered into negotiations, with almost every major region in the world, including Europe (Iceland and Norway), America (Chile, Peru and Costa Rica), Middle East (GCC), Africa (SACU), East Asia (Korea, HK and Macau), Southeast Asia (ASEAN and

Singapore), South Asia (Pakistan and India), and Oceania (New Zealand and Australia). In each region, China usually selects one trade partner to start the negotiations. In the author's view, this seems to indicate that China has some really clever strategy in structuring RTA deals to suit its best interest. One thing all these RTA partners share in common is that they are either RTA themselves, such as the ASEAN and Gulf Cooperation Council, or are members of another RTA deal.

Second, with the exception of ASEAN, Singapore and Australia, none of China's existing RTA partners are major trade partners of China. At the same time, however, China is always one of the top five trade partners with these economies. Thus, while China could afford to ignore these economies, none of them could afford to ignore China. With such asymmetric trade relationship, China could have more bargaining power in the RTA setting than at the multilateral level. This is very important for China as it does not have much experience in trade negotiations. By focusing on RTAs with those economies which are of minor importance to China, China could divert some of the trade with its major trading partners, so that it could further balance and diversify its import sources and export markets and would not be overly-reliant on one or several economies. At the same time, these RTA partners will have a lot of their trade diverted to China. This would further increase their reliance on China and further strengthen China's bargaining power and political clout.

Third, all economies that have entered or are about to enter RTA with China have recognized the market economy status of China. This is mainly concerned with a provision in China's Accession Protocol. As China is an economy with a long history of government planning in economic development, during its accession process, many WTO Members suspected that the Chinese government still interferes with micro-economic activities and thus doubted that the market data in China is really reliable. Thus, Section 15(a) of the Accession Protocol allows WTO Members to deem China as a non-market economy in antidumping investigations. The first step in anti-dumping investigations involves the determination of the existence of dumping, which is derived by comparing the export price and normal value. Normal value is usually the sale price of the product in the exporting economy. This provision, however, would allow WTO Members to

disregard the domestic sales price in China and use the prices from some surrogate economies or constructed price. Because the comparative advantages of China mostly come from the low costs of its factors of production, this provision makes it more likely for other WTO Members to arrive at a higher normal value and thus easier to determine the existence of dumping. This mechanism is available to WTO Members for up to 15 years after China's Accession. As this provision is highly technical, it was hardly noticed before and in the first couple of years after China's accession. In recent years, however, as more and more Chinese firms are subject to antidumping investigations abroad, people started to realize the damaging effect of this provision. Indeed, it was largely because of this provision, along with several other discriminatory provisions in China's accession package, that Mr Long Yongtu, the outspoken former chief negotiator in China's WTO accession, was called a "traitor" and likened to Li Hongzhang, the nineteenth century diplomat who allegedly sold China out by signing unequal treaties with Western imperialist powers on behalf of the late Qing government. The Chinese government was embarrassed with such criticism and tried to get rid of this provision. Theoretically, they could have the Accession Protocol amended by the WTO General Council, but this would be highly unlikely given that the General Council works on the basis of consensus and so far the only instance where consensus has been achieved was when the Members decided in late July of this year to suspend the Doha negotiations. The remaining option is for China to negotiate with each of its trade partners to recognize China's market economy status. As China has much more bargaining power at the bilateral/regional level, this strategy seems to be working. As of March 23<sup>rd</sup>, 2009, 79 economies have recognized the market economy status of China.<sup>30</sup> As more and more economies recognize China's market economy status, there would be mounting pressures on those who still deem China as a non-market economy to accept China's market economy status as an established precedent.

Fourth, in terms of the trade pattern, these RTA partners mostly export raw materials, energy products, or agricultural products to China, while they import mainly textile products and electronic products from China. In order to maintain its position as the "World Factory", China would need a steady supply of raw materials and energy; also, as most of the agricultural sector in China is not very competitive due to its low per capita land ratio, China needs to ensure supply of

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<sup>30</sup> <http://gpj.mofcom.gov.cn/aarticle/d/e/f/g/200903/20090306122237.html?1035433236=3154694964>.

agricultural products in order to free up its labor from agriculture and go into manufacturing. Thus, the RTA partners are probably chosen with these considerations in mind. Moreover, many of the RTAs also include investment provisions, which is another way for China to make sure that it can invest and subsequently control strategic resources.

Fifth, in the grand scheme of things, FTAs also provide a way for China to build up mutual trust with countries around the world and improve its image as a benign emerging power. With China's growing importance in the world stage, many countries started to feel the "China threat" with concerns that originate from China's ideological difference and political, military and economic weight. In East Asia, in particular, the United States-Japan coalition has historically exerted considerable political influence in Asia. Indeed, such influence has dragged China into quite a few conflicts and clashes with several ASEAN states during the second half of the twentieth century. With the amazing development in its economy, China once again has the opportunity to rise as a world power. China has maintained that it will adopt a course of "peaceful rise", which is interpreted by Prof. Zheng Bijian, the senior advisor to President Hu Jintao, to mean that:

"China will not follow the path of Germany leading up to World War I or those of Germany and Japan leading up to World War II, when these countries violently plundered resources and pursued hegemony. Neither will China follow the path of the great powers vying for global domination during the Cold War. Instead, China will transcend ideological differences to strive for peace, development, and cooperation with all countries of the world."<sup>31</sup>

However, the opportunity to seize the leadership role in Asia is too good for China to pass. As it would take quite some time before China could challenge the military dominance of the US

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<sup>31</sup> China's "Peaceful Rise" to Great-Power Status, Zheng Bijian, Foreign Affairs. New York: Sep/Oct 2005. Vol. 84, Iss. 5; pg. 18.

in Asia, the economic integration with ASEAN and other economies in Asia will be the way to achieve political ends using economic ways. When the ASEAN economies found out that they are too dependent on China for their economic well-being, they could hardly ignore the political message from Beijing. Therefore, even though many commentators have doubted the economic benefit to China from an ASEAN-China FTA as the two are competitors on many products, China has adopted the guideline of “give a lot while demand little”<sup>32</sup> in the FTA negotiations as the political significance of such an FTA greatly outweighs economic considerations.

Sixth is the Taiwan factor. Since the Nationalist government retreated to Taiwan 60 years ago, cross-strait reunification has become one of the most important political problems facing the Mainland government. At first the Mainland tried military and political means, which have largely been unsuccessful. In recent decades, with the growing economic ties between the two sides, the Mainland government has switched to FTAs in an effort to lure back the renegade province. Such strategy includes several components:

First, use FTA to entice the small and already dwindling group of countries that maintains diplomatic relationship with Taiwan to switch sides. For example, in June 2007, Costa Rica ended its ties of over six-decades with Taiwan and instead established formal diplomatic relationship with China. One may argue that Costa Rica’s main motivation is political, i.e., gain the support of China to be elected a non-permanent member of the UN Security Council.<sup>33</sup> At the same time, however, fostering stronger economic ties with China is probably another important consideration, as Costa Rica was soon selected by China as the first FTA partner in Central America. In a way, the Costa Rica FTA is also China’s fight-back against Taiwan in Central America, one of the island’s few remaining spheres of influence in the world. In the four years before Costa Rica’s “betrayal”, Taiwan has signed a flurry of FTAs, all with Central American countries: Panama (signed August 2003), Guatemala (signed September 2005), Nicaragua (signed June 2006), El Salvador and Honduras (signed November 2006).<sup>34</sup> In addition, Taiwan has started FTA

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<sup>32</sup> Remarks on the China-ASEAN FTA by Mr. Bo Xilai, the Minister of Commerce of China, July 21, 2006, available at <http://boxilai.mofcom.gov.cn/column/print.shtml?/speeches/200607/20060702702431>.

<sup>33</sup> [http://goliath.ecnext.com/coms2/gi\\_0199-7140637/COSTA-RICA-S-SOPHISTICATED-AND.html](http://goliath.ecnext.com/coms2/gi_0199-7140637/COSTA-RICA-S-SOPHISTICATED-AND.html).

<sup>34</sup> Bureau of Foreign Trade of Taiwan, Pushing for FTAs, <http://cweb.trade.gov.tw/kmi.asp?xdurl=kmif.asp&cat=CAT514>.

negotiations with Dominican Republic, while the negotiation with Paraguay has been stalled over the approval of other Mercour member countries.<sup>35</sup> Once Costa Rica concludes the FTA with China and starts to reap considerable economic benefits, the other Central American countries will probably have to reconsider the costs and benefits in maintaining diplomatic ties with Taiwan.

Second, use the Closer Economic Partnership Arrangements (CEPA) with Hong Kong and Macau as a model for future deal with Taiwan. In terms of both the breath of the coverage and the depth of the concessions, the two CEPAs far exceeds the RTAs China have concluded.<sup>36</sup> This is understandable as Hong Kong and Macau are both regions of China, even though they each are separate Members in their own right at the WTO. By offering Hong Kong and Macau a better deal than other FTA partners, China is also signaling to Taiwan that the same level of access to the largest market in the world could be extended to the island. Of course, there is no free lunch in the world. Hong Kong and Macau were able to get such a good deal because they are both sub-central regions in the People's Republic. Initially, it seems that Beijing would insist on Taiwan accepting the same status rather than holding on to its claim of an independent sovereign state. This is reflected in the careful selection of the name of the agreement with Hong Kong and Macau. During the negotiations leading to the conclusion of the CEPAs, it has been suggested that they should be called FTAs. In the end, however, they were named as "Closer Economic Partnership Arrangements" instead. In substance, the two CEPAs are no different from the other FTAs around the world. Moreover, legally speaking, China, Hong Kong and Macau would run the risk of violating their MFN obligations unless they treat the CEPAs as FTAs, which allow them to invoke the exception provided for under Article XXIV of the GATT.<sup>37</sup> By calling them "arrangements" rather than "agreements", however, the mainland authorities were trying to avoid the impression that China was signing "international agreements". Instead, they are just some "arrangements" offered by the Central Government to local governments. Initially, China had insisted on using the same name for the deal with Taiwan. Recently, however, China has softened its position by agreeing to

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<sup>35</sup> [http://www.bilaterals.org/article.php3?id\\_article=266](http://www.bilaterals.org/article.php3?id_article=266).

<sup>36</sup> For a discussion of the coverage of the China-Hong Kong, China CEPA, see Henry Gao, *The Closer Economic Partnership Arrangement (CEPA) between Mainland China and Hong Kong - Legal and Economic Analyses, TRADING ARRANGEMENTS IN THE PACIFIC RIM: ASEAN AND APEC*, III.C.6., Oceana Publications, New York, 2004.

<sup>37</sup> Indeed, China; Hong Kong, China and Macau, China have effectively conceded that the CEPAs are RTAs by notifying them to the CRTA for review.

accept the more neutrally-sounded ECFA (Economic Cooperation Framework Agreement) as the name for the future agreement.

Third, use the proposed ECFA with Taiwan to further integrate Taiwan into the economy of the Mainland. Whatever its name, the ECFA will significantly boost the already-substantial Taiwanese investment in the Mainland, legalizing cross-strait direct trade which has so far been prohibited by Taiwan's age-old Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area. The deeper the economic integration between the two sides, the more difficult it will be for Taiwan to be politically separate from China. Eventually, the economic ties between the two sides will be so strong that Taiwan will become more dependent on China than probably even Hong Kong and Macau.

Seventh, FTA also provide an effective way for China to push for trade liberalization in selected markets even though the multilateral negotiations have been moving only at a disappointing pace. With the slow progress in the Doha Round, RTA has become the only feasible option to achieve trade liberalization. While this holds true for all WTO Members, China in particular has more to gain from bilateral-regional negotiations as it is placed in an awkward position in the current multilateral negotiations. First of all, As a newly-acceded Member, China is required to undertake a lot of commitments, many of which are higher than those of existing WTO members. It is already a humongous challenge for China to try to implement these commitments. After having been in the spotlight for 15 years, what China needs now is some quiet breathing space, which it can only get at the bilateral-regional level as China had to face the annual transitional review and bi-annual TPR in the WTO. Second, with most of its exports concentrated in labour-intensive or resource-intensive products, China would compete with rather than complement the industrial structure of other developing economies. It is no wonder that other developing economies view China as a competitor rather than a friend. Indeed, notwithstanding that the Chinese government has repeatedly held that China is, and always will be, a developing economy, and in spite of the fact that the per capita GDP in China is comparable to that of many LDCs, China is also the third largest trading power in the world and the only one among all developing economies to be among the top five traders worldwide. Thus, on many issues, China's interest is actually closer to that of major

developed economies than that of developing economies. Agriculture is one such example: as China imports a large quantity of agricultural products, it is actually not in China's interests to follow the position of most developing economies and demand the elimination of export subsidies. Trade facilitation, one of the four "Singapore Issues," is another such example: as China exports a lot, it is actually in the interest of China to push for the inclusion of trade facilitation in the WTO framework to make the customs process more efficient and cheaper. However, as China has formally joined G-20, the major developing country grouping in the WTO, it would be embarrassing for China to publicly depart from the G-20 party-line in Doha negotiations. At the bilateral-regional level, China would have more flexibility in asserting its true interests.

Eighth, FTA negotiations also provide a good opportunity for China to build up its trade negotiation capacity. Compared with other regions which have long been active in trade negotiations at both multilateral and regional levels, East Asia lagged behind. By engaging in FTA negotiations, these countries could develop the necessary negotiating expertise. Of course, it would not be good policy to risk FTAs with economically significant partners for the sake of honing the negotiating skills of the officials. This also explained why China chose to start the FTA negotiations with some countries that are less important economically. It's interesting to note that other countries in the region, such as Korea, also adopted the same strategy in its FTA negotiations.<sup>38</sup>

## **V. Conclusion**

While initially reluctant to engage in FTA negotiations, China has gradually become an active player in the global rush to FTAs. While the number of China's FTAs still lags behind other major players, it is rapidly growing. As one of the most important trading nations in the world, China's decision to pursue an active path of FTA negotiation will undoubtedly have implications for all countries in the world. In particular, countries in Southeast Asia would be affected most by

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<sup>38</sup> See Park & Koo, noting that Korea selected Chile as its first FTA partner with the explicit goal of capacity building.

China's FTA move. Before they could decide how to respond to China's FTA shopping spree, they must first understand China's FTA strategy. In this paper, the author provides a critical analysis on this issue from economic, geo-political and legal perspectives. The paper argues that, while economic considerations might be an important factor in China's decision to pursue FTAs, the main motivation seems to have been political considerations so far. In essence, China has been trying to use its FTA network to foster and reward strategic allies as part of its strategy to build an international environment conducive to China's goal of "peaceful rise". This presents challenges and opportunities for different countries. While some countries could be chosen as an FTA partner due to its strategic importance, other countries might be left out for lack of strategic value. Thus, paradoxically, it seems that the best way to jump on China's FTA bandwagon is to enhance a country's political significance rather than strengthening economic ties with China. In a way, this is another tale of how politics has gone global with the help of trade, and hijacked trade into becoming its handmaiden during the process.

~THE END~