

China and the Multilateral Trading System

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For more than two decades, China's rapid growth has been driven by its global economic engagement. Since its accession to the WTO in 2001, foreign trade and foreign direct investment have made even more important contributions to Chinese growth. Between 2001 and 2005, for example, the dollar value of Chinese exports and imports increased at annual rates of 29.3 and 25.3 percent respectively and in 2005, 58 percent of Chinese exports originated from foreign owned firm. As a result of this performance, China's share in world imports increased from 3.3 in 2001 to 5.9 percent in 2004 and its share in world exports from 3.9 percent in 2001 to 6.5 percent in 2004. This makes China a major participant in world trade and having now surpassed Japan, the dominant trading power in East Asia¹ China looms particularly large as an exporter of labor- intensive manufactured goods and components and as a major importer of capital goods, primary commodities and semi-finished parts.² It is also the developing world's largest recipient of direct foreign investment.

Given its size, the pace of its expansion, and its outward orientation, China is likely to have a growing impact on the global trading system and its policies are likely to have an important influence on the system's evolution. These policies have been as dynamic as its trade and investment performance. In 2001 after fourteen years of negotiations, China became a full member of the WTO, assuming obligations that are at

¹ In 2003 and 2004 china accounted for 10.6 and 8.9 of the growth in world imports and 10.5 and 9.7 of world exports.

² Having assumed the ranks of the world's third largest trader, Chinese trade policies will now be subject to the WTO Trade review mechanism every two years – a treatment reserved for countries with large trade volumes.

the level of many developed economies. Since that time it has participated actively in the institution's activities and negotiations. In part to meet the conditions of its accession, China has also dramatically liberalized its domestic economy and introduced a large number of internal policies that consolidate its transition to a market economy. In addition, China has adopted a multi-track trade policy strategy, complementing its WTO and domestic liberalization policies with regional trading initiatives. By 2005, China had completed four FTA agreements (Thailand in 2003, Hong Kong and Macao in 2004 and Chile in 2005) and as estimated by Wong and Hufbauer have proposed and/or launched negotiations for least another fifteen.³

What do these policies portend? When China proposed joining the WTO several concerns were raised. One was that the system as a whole could be weakened because China was not a fully market driven economy and was therefore unlikely or unable to adhere to the WTO rules. China then acceded to the WTO under very demanding terms and there were fears that either deliberately or inadvertently it would not implement these commitments.⁴ This would put other members in the difficult position of either (a) trying to compel compliance with trade retaliation and other sanctions that could increase frictions or (b) ignoring Chinese infractions thereby undermining the WTO system in establishing an international rule of law to which all members adhered.

A second concern was that China would not participate constructively in the WTO. It would throw its weight around, try quickly to obtain disproportionate influence

³ See Gary Clyde Hufbauer and Yee Wong, "Prospects for Regional Free Trade in Asia" Washington DC: Institute for International Economics, Working Paper Number WP-05-12. October 2005. Their list of proposed agreements includes APEC, East Asia, South-East Asia, Brazil, GCC, India, Mexico, New Zealand, Peru, Singapore, South Africa, Mercosur, Australia, Chile, Iceland, Japan, Korea and Pakistan.

⁴ Glenda Mallon and John Whalley for example express concern about that Chinese policy instruments would generate many new trade disputes. See "China's Post Accession WTO Stance" NBER Working Paper No. 10649 August 2004.

and use its influence to fundamentally change the WTO system. China was also seen as a potentially powerful addition to the ranks of developing countries, and many in the developed world worried that it would seek to limit the obligations required of developing countries.

More recently a third set of questions is being raised with respect to China's trade policies in the East Asian region. Would Chinese regional initiatives undermine the multilateral trading order? Is China seeking to establish an East Asian trading bloc under its leadership that discriminates against outsiders? Will it use its market to create a hub and spoke system in East Asia in which China gains serves as the hub and the other countries are the spokes? Finally there is the fear that not only China but other countries in the region are creating a system of overlapping trade regimes – or a noodle bowl – that could impose unnecessary trading costs, induce harmful trade diversion, and actually fragment rather than integrate the regional economy.

This paper, considers these questions. Chinese policies are analyzed with a view to determining the direction they are taking and the effects they are likely to have on the multilateral system. The discussion first considers China's participation in the WTO. It reviews the terms of accession, China's current tariff and trade regime and its participation in the Doha Round negotiations and the institution's regular activities. The analysis concludes that China's trade policies are broadly supportive of a rules based multilateral trading order. China has accepted and implemented obligations that go far further than most developing countries. It has been interested in using the system to advance its interests rather than in changing it.⁵ Its behavior at the WTO is thus more

⁵ See Margaret M. Pearson, *China's Multiple Personalities in Geneva: Constructing a Template for Future research on Chinese Behavior in WTO* University of Maryland (mimeo) 2003.

akin to that of a status quo power than one seeking major systemic changes. The discussion then turns to China's FTA initiatives. These are still a work in progress, and their implications are uncertain. Concerns about an East Asian fortress appear misplaced. Directly, and through their impact in inducing others to respond, these FTAs could provide a powerful impetus to the process of competitive global liberalization. Countries that do implement agreements with China will find it relatively easy to open their markets to other developing countries. There is also a risk that the proliferation of FTAs will lead to web of overlapping agreements that could make the trading system unnecessarily complex.

China's policies both at home and abroad are still evolving and thus major shifts in the direction and nature of the policies cannot be ruled out. Accordingly, the final section considers four factors that could play an important role in influencing outcomes in the future. These are the precise terms of the agreements that are concluded, China's domestic implementation of its commitments, the impact of currency appreciation on China's competitiveness and protectionist responses to China by other countries.

Section I: China in the WTO

The WTO operates by consensus. Any country seeking to join must essentially satisfy all existing members before they will permit it to accede. To be sure, formally, there is a requirement for decisions on accession to be approved by a vote of two thirds of the Members (Agreement Establishing the World Trade Organization, Art XII.1) and there are also provisions allowing existing and acceding members a one time opportunity to opt out from extending MFN provisions when countries accede (Agreement Establishing the WTO Art XIII) but in practice unanimity is sought and most

countries receive full MFN treatment. The need to obtain such approval means that new members are often asked to assume obligations that are far more extensive than existing members at an equivalent stage of economic development.

Accession Commitments. The terms of China's accession to the WTO exemplify these propositions. Although China is a developing country and thus in principle entitled by the WTO's "enabling clause" to special and differential treatment, the United States and other WTO members were successful in insisting that China enter the WTO on "commercial terms". This meant that China assumed obligations that in many cases went far beyond those expected of existing members at its stage of development. These commitments involved not simply reducing border barriers but undertaking detailed changes in internal policies.

Upon accession China was required to make major tariff reductions and by 2007 to reduce average import-weighted average tariffs to 6.8 percent.⁶ This is a major additional decline in tariffs which had averaged 40.6 percent as recently as 1992 and is almost half the average level in place upon accession. Almost all China's non-tariff trade barriers have to be removed. Nearly all imports and export quotas and licenses had to be removed by 2005 and those that did remain to be administered in a transparent manner. By 2005, all firms were to be allowed to import and export goods. China also agreed to implement the WTO TRIMs agreement without exceptions and thus could no longer make the permission to invest or import contingent on performance requirements such as earning foreign exchange or using domestic content. Restrictions on foreign participation in the distribution sector were to be phased out within three years. China also agreed to

⁶ Razeen Sally, "China's Trade Policies and its Integration into the World Economy" Paper prepared for IGD/SAIIA SACU-China FTA Workshop, Johannesburg, 28-29th September 2004.

the TRIPs and it adopted the WTO SPS and TBT Agreements immediately upon its accession.

There were also a host of commitments with respect to policy transparency including obligations to translate into English and publish new laws and regulations and to establish inquiry points for foreign firms and governments. Time is be allowed for comment before laws are promulgated and new tribunals established to review administrative acts relating to WTO implementation with the right of appeal to higher judicial bodies.

Although the WTO is in principle based on non-discrimination China was also compelled to agree, on a transitory basis, to permit members to subject it to discriminatory treatment. First, it agreed to both a special selective safeguard that could be used against its exports for twelve years after its accession. It also agreed to an additional safeguard provision for textiles and apparel that would be in force until the end of 2008 and could be (and has been) used temporarily to deny it the full benefits of the expiration of the MFA in 2005;⁷ Second, China agreed to accept non-market economy status for the purposes of anti-dumping rules until the end of 2015. This would allow countries to use specially constructed prices in evaluated claims of dumping brought against Chinese exporters; and third, China allowed the WTO setting up a transitional Review Mechanism that would review its implementation record annually for the first ten years of its membership.

These demanding terms were useful for Chinese reformers. Before its accession to the WTO, China's initial domestic reforms involved taking tentative steps towards

⁷ Par 242 of the report of the Working Party on the Accession of China”

introducing a market system to its economy. The enterprises that played a leading role in these reforms, however, were generally owned by foreign investors and local Chinese governments rather than private Chinese entrepreneurs. WTO membership strengthened the hand of reformers seeking to hasten China's movement towards a more developed market economy. The benefits from WTO accession became an added reason for undertaking the domestic reforms needed to join the organization. WTO entry has allowed China's leadership to make a more credible commitment towards moving China towards a system that more fully recognizes private enterprise.

The requirements of WTO entry forced Chinese policymakers to confront politically difficult issues. These included reforming domestic banking institutions, subjecting state-owned enterprises to harder budget constraints, and allowing private firms to freely engage in international trade. WTO entry also mobilized domestic firms to become more competitive through restructuring, acquiring new technologies, and forming new alliances and mergers with both domestic and foreign firms.

The WTO accession process also served to promote better Chinese governance. The WTO requires policy transparency and the enforcement of domestic trade policies on the basis of rules rather than bureaucratic discretion. WTO membership also necessitates non-discrimination (i.e. national treatment) for imported goods and services. China remains a country with considerable domestic barriers and strong provincial governments. If provinces are forced to provide national treatment for imported goods and services, they will find it harder to discriminate against goods from other provinces. Many of these reforms are changes that China might have chosen to implement anyway, but entry into the WTO served to advance their implementation.

In 2004, as reported in Table 1 below, these requirements were apparent in China's tariff regime and WTO commitments. China had bound one hundred percent of its tariffs—a discipline which most other Asian and many developing countries and developed countries have not accepted. Unlike almost all developing countries that have average bound rates far in excess of their applied rates, there is almost no water in China's tariffs. Its average applied rates in 2004 of 10.4 were converging closely to its final bound rate average of 10 percent. China's average applied rates on non-agricultural products of 9.5 percent in 2004 were similar to those of Malaysia 9.1 and converging to the levels of Korea and other East Asian economies of around 6 percent. They were already far below the average non-agricultural rates applied by other major developing countries such as Brazil 12.7, Egypt 19.5, India 27.9 and Mexico 17.1. China's average applied tariffs on agricultural products of 16.2 percent are similar to those of the Philippines and Chinese Taipei and far below those of Korea, Thailand, Egypt, India and Mexico.

China's services liberalization is also very impressive. Commitments have been made for ninety three sectors, a number way above the typical developing country or ASEAN member and quite in line with the commitments of Korea (98 sectors) and South Africa (91 sectors.) Among noteworthy commitments: the banking sector is to be completely open to foreign competition by the end of 2006. In telecommunications up to 49 percent ownership is to be allowed by 2006. The Insurance sector was also extensively liberalized. Foreign securities houses were allowed minority equity and several professional services, most notably legal were liberalized as well.

Table 1. Trade Policy Profiles, 2004

Country	<u>% bound</u>	<u>Final Bound</u>	<u>Applied Total</u>	<u>Agriculture Applied</u>	<u>Non-Agric. Applied</u>	<u>Services #sectors</u>	<u>WTO Case</u>	<u>AD Cases</u>
China	100	10	10.4	16.2	9.5	93	1/0	71
Other Asia:								
Indonesia	96.6	37.1	6.9	8.2	6.7	45	2/4	7
Korea	94.5	15.9	11.2	41.6	6.7	98	8,8	32
Malaysia	83.7	14.5	8.4	3.3	9.1	73	1,0	12
Philippines	66.8	25.6	6.3	9.5	5.8	51	0,0	0
Singapore	69.2	6.9	0	0	0	67	0,0	0
Taipei, Chin	100	6.1	6.9	16.3	5.5	119	0,0	3
Thailand	74.7	25.7	15.4	29.6	13.3	75	5,1	22
Other developing								
Brazil	100	31.4	12.4	10.3	12.7	43	12,2	50
Costa Rica	100	42.8	5.9	12.2	4.9	44	0,1	0
Egypt	99.1	36.6	19.9	22.5	19.5	44	0,1	15
India	73.8	49.8	29.1	37.4	27.9	37	8,5	191
Mexico	100	34.9	18	24.3	17.1	77	5,3	63
South Afri	100	19.1	5.8	9.1	5.3	91	0,0	
Developed								
Australia	97	9.9	4.2	1.2	4.6	103	5,2	52
Canada	99.7	5.1	3.9	3	4	105	12,10	59
EU	100	4.1	4.2	5.9	4	116	26,21	167
Iceland	95	13.4	2.9	6.5	2.4	113	0,0	0
Israel	76.4	20.8	5.6	15.9	4	58	0,0	6
Japan	99.6	2.9	3.1	7.3	2.5	112	8,6	2
Norway	100	3	1.2 na		0.6	111	1,0	0

http://stat.wto.org/CountryProfiles/S*defendant/claimant

WTO Participation. Appraisals of China's performance at the WTO are generally positive.⁸ Its delegation is regarded as being of high quality. It has participated actively in regular WTO activities. Remarkably, it has only been involved in one dispute as a complainant (US steel safeguards) and two as a defendant. There was a case initiated by the United States in March 2004 relating to preferential value added tax for domestically designed integrated circuits⁹ and currently there is a case regarding auto parts in which both the US and the EU allege China has violated its commitments. In several other cases where China has been challenged they have quickly come into compliance.¹⁰ China has also participated in 47 cases as a third party something which both the EU and US

⁸ According to Pearson, "on a personal level, China's interlocutors at the WTO, as at APEC, are uniformly complimentary about the quality of China's delegation".

⁹ The case resulted in a mutually agreed solution in October 2005 China agreed to amend or revoke the measures at issue.

¹⁰ Author's private communication with a US trade lawyer based in China.

routinely do to ensure that they have the right to defend their interests should the need arise. This participation is a clear demonstration that China views its interests as systemic and that these go beyond only those disputes in which it is directly involved.

China has also been active in the Doha Round negotiations. Non-Agricultural Market Access (NAMA) is the area of greatest importance as an offensive objective. China would like to as much liberalization as possible by other countries while at the same time insisting on special treatment for countries that have recently acceded. China has engaged actively in NAMA discussions of formulas that should be employed for tariff reduction. In agriculture its positions are more mixed. It is very interested in reducing subsidies and protection in developed countries. It chose to participate in the G20 formed at Cancun in order to press these claims although it has not been particularly active in joining other groups. It would also like to see lower barriers to its agricultural exports to developing countries. On the other hand, China also seeks some flexibility in commitments assumed by developing countries to assist poor farmers and promote rural development. In the services area, China also has a particular interest in mode-four liberalization the movement of natural persons. This would increase opportunities for Chinese workers to work abroad . China is particularly concerned about rules. It seeks more disciplines on anti-dumping practices such as zeroing for example. China has also voiced its support for trade facilitation although it is not particularly interested in such assistance for itself. It has also not been a vociferous advocate of S&D treatment because

it clearly has an important interest in seeing developing countries with large markets such as India and Brazil making meaningful liberalization commitments.¹¹

Overall, therefore, in the Round, China has not tried to take as a strong a leadership role as Brazil, but it has by no means been passive. This is also true of its activity at the WTO more generally. Hakan Nordstrom has undertaken a very interesting analysis of country participation in WTO activities. He has collected data on all written submissions members have undertaken both individually and with others in 2003. These reflect activities undertaken both in the ruling bodies of the WTO as well as in the Doha Round negotiations. *China emerges in these data as the most active developing country and the third most active WTO member.* Its total of 65 written submissions was considerably below those for the EU (120 submissions) and the USA (116), but greater than India the second most active developing country participant. The detailed data reported in appendix Table 1 indicate that China was especially active in the Rules Committee with 18 submissions, ten of which related to subsidies and countervailing duties.

Table 2. Top 10 WTO participants (written submissions, 2003)

Rank	Member	Category	Overall	Individual	Joint
1	EC	D	120	105	15
2	USA	D	116	109	7
3	China	DC	65	48	17
4	Japan	D	61	44	17
5	Australia	D	50	44	6
6	India	DC	48	16	32
7	Switzerland	D	46	23	23
8	Chile	DC	45	16	29
9	Thailand	DC	44	16	28
10	Canada	D	43	36	7

¹¹ Pearson makes the interesting point that China has not been a participant in coalitions of developing countries that have resisted liberalization such as the “Like-minded Group” that focused on the difficulties of developing country implementation (page 23)

Source: Nordström¹²

In most respects, therefore, China appears as a constructive member working to pursue its interests which for the most part correspond to the organization's goals of greater multilateral liberalization. There are however two matters in which China has been more aggressive and even recalcitrant. Both reflect powerful domestic political concerns. The first relates to Taiwan. Members of the WTO are officially customs territories rather than sovereign nations. As such China could tolerate the accession of Taiwan which also occurred at Doha. At the same time, however, the government of China has fiercely fought any gesture by WTO members that could imply that Taiwan enjoyed sovereign status. This has led to testy interactions when Taiwan attempted to exercise its rights to formal consultations. In 2003, there was also considerable friction in response to Chinese efforts to downgrade Taiwan status from "permanent mission" which could imply an independent country to office of permanent representative"¹³

China has also been visibly unenthusiastic about the annual Transitional Review Mechanism it is forced to undergo. China is required by the terms of accession agreement each year to provide an extensive amount of data regarding its policies and performance and then to submit to questioning by other members. These reviews are a nagging reminder about the terms of its accession that some in China viewed as having been a sell out. They also appear to question China's integrity and its willingness to honor its legally binding commitments. China grudgingly sticks to the letter of law in meeting this

¹²Håkan Nordström " *Participation of developing countries in the WTO - new evidence based on the 2003 official records*" National Board of Trade, Sweden (mimeo) 2005.

¹³ Pearson op. cit. page 16.

commitment, giving only oral answers to questions that are often less than forthcoming. It is clearly an unwilling participant and does not take kindly to the treatment.

All told therefore, China is seeking normalcy not special treatment and this is something it will gain once the transitory arrangements associated with its accession expire. Within a decade, special safeguards, non-market status, and transitional review mechanisms will expire and China will gladly assume its role as a more normal but very important WTO member.

What accounts for the way in which China has participated in the WTO? Why has it chosen to be constructive and yet not highly assertive? China is constructive because the WTO is a very attractive institution for China that clearly serves its interests. To be sure, China was important enough to receive MFN treatment from almost all countries even prior to joining, and some suggested that by joining under such demanding terms, it was opening itself up to challenges that could have actually reduced its market access.¹⁴ But, for the most part such challenges have been conspicuous by their absence, and China now enjoys unconditional MFN treatment and the ability to enforce its rights through the dispute settlement system.

China's political relations with other countries are often problematic because of the undemocratic nature of its system of government and its poor record on human rights. This gives China a great interest in a strong, rules-based WTO because it allows its trade and investment issues to be placed a less political, more technical track. In addition, since China does not have FTAs or benefit from preferences in its major developed country markets -- the US, EU and Japan (so far) -- the MFN terms on which access to these markets is granted is especially important for China.

¹⁴ See Mallon and Whalley op. cit.

Bargaining at the WTO is done on the basis of reciprocal concessions. This means that those with the largest markets exercise the greatest power. China's large and growing market and its willingness and ability to liberalize position it naturally to exercise influence. But so far, it has been prudent in the way it has exercised this power. This is because China also seeks to be a leader of the developing countries and its economic interest in liberalization and competitiveness in exporting come into conflict with the desire of many developing countries to seek special and differential treatment and benefit from preferential access. This leads it to be less outspoken about its interests than it might otherwise be and allows China to leave the demands for developing country liberalization to the developed countries.

Historically, times during which new powers are arising on the global stage have been filled with tension. And the real challenge for the rest of the world lies in ensuring that an emergent China has incentives to engage the rest of the world in a cooperative and peaceful fashion. China's performance at the WTO suggests that at least so far, by allowing China to join, the rest of the world has helped meet this challenge.

Section III: Regional Arrangements.

Like almost every other WTO member, China has not confined its trade policy to the WTO.¹⁵ Instead, it has both embraced and stimulated the current global trend towards Free Trade Agreements.¹⁶ China has concluded several agreements and is in the process of negotiating many more. In 2001, it began talks with ASEAN that

¹⁵ Some countries, embarrassed by the need to explain why they are departing from a pure multilateral strategy use the excuse of slow movement in the Doha Round as the reason why they are suddenly launching into a large number of FTAs but this is not generally very persuasive since some of the countries making this excuse are among the least forthcoming. This is not, however, an argument made by the Chinese government.

¹⁶ For an excellent overview see Agata Antkiewicz and John Whalley "China's New Regional Trade Arrangements" NBER Working Paper 10992 December 2004.

resulted in an agreement to eliminate tariffs and continue with a view to obtaining agreements with respect to investment and services. In 2003 an agreement in agriculture was concluded with Thailand. In 2004, Hong Kong & Macau signed agreements with the Mainland. In 2005, an agreement with Chile was concluded and there are currently ongoing FTA negotiations with Australia, New Zealand, Pakistan, the Southern Africa Customs Union and the Gulf Cooperation Council. Other discussions that are ongoing include Brazil, Iceland, India, Japan and South Korea. In what follows, I first describe some of these agreements and then appraise their significance.

Asean. In 2002 a framework agreement on Comprehensive Economic Cooperation was signed with ASEAN to serve as guide for achieving an FTA that covers goods services and investment. The goal is to have an FTA in place by 2010 among the more advanced of these countries. The newer ASEAN members (Vietnam, Laos, Myanmar and Cambodia) will have until 2015 to comply. An early harvest program reduced or eliminated tariffs in about 10 percent of lines by 2006. Most other tariffs are to be eliminated on between 2005 and 2010, by which time 90 percent of tariff lines should be covered. The remaining 10 percent are deemed sensitive and will be removed at a slower pace.¹⁷ There are also ongoing negotiations with respect to services and investment and expectations that ASEAN could obtain benefits from acceleration in China's WTO service liberalization commitments.^{18,19}

¹⁷ The sensitive groups of products would have their tariffs slashed starting in 2012 to reach a level between zero and 5 percent by 2020, while highly sensitive goods may maintain their import duties but only to a maximum 50 percent in 2020.

¹⁸ Singapore government website.

¹⁹ Investment Negotiations It has been agreed that the ASEAN Investment Agreement (AIA) would be used as a template for investment negotiations.

China has heralded this agreement. Its press observes

“The China-ASEAN FTA will form a huge market, with 1.85 billion consumers and a combined gross domestic product of almost US\$2.5 trillion. The value of imports and exports of this zone will hopefully exceed that of the NAFTA (North America Free Trade Agreement) by 2010 and its GDP will likely be higher than that in the European Union market. These three, China-ASEAN free trade zone, NAFTA and the EU, will become the three pillars of the world economy.”²⁰

China has also had talks on bilateral FTAs with some of the ASEAN countries. In particular it concluded the agreement with Thailand that focused on fruits and vegetables in 2003. It also started talks with Singapore but these were suspended over a fallout on Taiwan.

Hong Kong and Macao. The Closer Economic Partnership Arrangement (CEPA) Agreement signed by China and Hong Kong was the first completed FTA agreement signed by both parties. Its stated purpose is “to strengthen trade and investment cooperation by liberalizing tariff and non-tariff barriers on substantially all trade, liberalizing services and promoting trade and investment facilitation.” (CEPA Pre-
Amble)

The CEPA Agreement specifically makes clear that the parties will not apply the provisions of China’s WTO accession that allow countries to (a) subject China to non-market economy status in the application of anti-dumping; and (b) impose special

Cooperation

ASEAN and China have also agreed to cooperation focusing on 5 priority sectors namely: agriculture, ICT, HRD, investment and the Mekong River Basin development, and 11 other activities including the acceleration of the Singapore-Kunming Railway Project

²⁰ These were the remarks by Wang Jinzhen, spokesman of China Council of Promotion of International Trade (CCPIT), in Xiamen, Sept.7

Remarks by Wang Jinzhen, spokesman of China Council of Promotion of International Trade (CCPIT), in Xiamen, Sept.7

safeguards on all trade until 2012 and on textiles through 2008.²¹ The schedules of the Agreement provide for the Mainland to eliminate duties on all products of Hong Kong origin (except prohibited articles) provided that CEPA rules of origin are met. Both sides also eliminate the application of anti-dumping measures or countervailing measures although they can apply safeguards. Services are liberalized using a positive list approach and in accordance with WTP practice extends the preferential treatment to “service suppliers of other WTO members that are engaged in substantive business operations.” Financial cooperation is given a lot of attention. The Mainland supports state-owned banks in relocating their treasure and foreign exchange trading centers to Hong Kong, in making acquisitions, using Hong Kong financial intermediaries, cooperative financial regulation, and the listing of insurance companies in Hong Kong. “The liberalization permits earlier access for Hong Kong service suppliers to the Mainland market, ahead of China's World Trade Organization (WTO) timetable. In some sectors, like audiovisual services, transport services and distribution services, the concessions go beyond China's WTO commitments.”²² There are specific provisions for cooperation in financial services (banking, securities and insurance) tourism, and trade and investment facilitation, and for encouraging the mutual recognition of professional qualifications and exchange of “professional talents”. “The two sides shall resolve any problem arising from the interpretation or implement of the “CEPA” through “consultation in the spirit of friendship and cooperation.” A Joint Steering Committee with officials designated by

²¹ These are contained in Articles 15 and 16 of the “Protocol on the Accession of the People’s Republic of China to the WTO” and par 242 of the “Report of the Working Party on the Accession of China” China

²²Trade and Industry Department of Hong Kong Web Site
<http://www.tid.gov.hk/english/cepa/details/note.html#goods>

both sides will make decisions by consensus. (Art 19:5) The Agreement signed with Macao follows a very similar template.

Since Hong Kong did not apply tariffs on Chinese goods, for China this agreement clearly was not about eliminating tariffs on its exports. It was given greater security from anti-dumping and countervailing actions. However there are additional advantages. First, it signaled the special status of Hong Kong, second it gains relief from the discriminatory treatment in the WTO agreement. Third, it clearly used the agreement to signal government support for mainland financial institutions in Hong Kong. In addition it provides services firms in Hong Kong first foreign mover advantages. Indirectly, it also provides advantages for Hong Kong over Taiwan.

Chile. In 2005 China and Chile concluded an FTA. The two countries took less than a year to negotiate the accord, which immediately eliminates tariffs on 92% of Chile's exports to China and 50% of the products that China sends to Chile. The pact does not cover services.²³ In 10 years after the start of the tariff concession process, the import tariff of 97% of the tariff lines of both sides will be zero. Furthermore, the Agreement provides that the two Parties may accelerate the tariff concession upon consensus through consultation.

New Zealand hopes to become the first developed country to sign an FTA with China. It has already become the first developed economy to grant it market economy status. The FTA talks have gone on for several years. The New Zealand government,

²³ China-Chile FTA will start the comprehensive tariff concession in the latter half of 2006. At the Chilean side, the import tariff rates of 74% of the tariff lines will be lowered to zero immediately after the Agreement takes effect, while at the Chinese side, 63% of the import tariff lines will have zero rate within 2 years; The remaining import tariff lines of both Parties, will be zero rated 5 to 10 years after the Agreement becomes effective. Each party may keep only 3% of the tariff lines as exceptions with tariff rates unchanged.

which was criticized for signing an agreement with Thailand that failed to include services, is insistent that the deal should be comprehensive and in addition to covering covers goods, services and investment, include provisions for rules of origin, trade remedies, intellectual property and government procurement.

Australia. China is also involved in FTA talks with Australia. Again the memorandum of understanding that launched the talks granted China market economy status. The Australian Government has also made clear that it is seeking a comprehensive agreement that applies to “substantially” all goods, trade in services “as well as other non-tariff issues such as the recognition of standards, customs cooperation, protection of intellectual property rights and regulation of foreign investment.”^{24 25} Australia is a highly competitive producer of agricultural and mineral products. In 2005, it accounted for 98 percent of all Chinese beef imports, 12 percent of dairy imports, and significant amounts of cotton and wool. There are significant exports of barely, wheat, hides and skins and wine and very substantial quantities of iron ore, uranium, non-ferrous metals. Given Chinese tariffs on agricultural products of 15.3 percent and on Australian manufactured goods of up to 45 percent, the amount of liberalization for China could be substantial.²⁶ On Australia’s part, the quid pro quo would be liberalization of tariffs on

²⁴ Australia-China Free Trade Agreement, Australian Government, Department of Foreign Affairs and Trade, March 2006.

²⁵ The Government also stresses “we will not be rushed. The Australian Government has stressed that any FTA with China must deliver real gains for Australian businesses across the board. That is, it must be comprehensive – covering goods, services and investment –and be completed as a single undertaking.” Ibid.

²⁶ In a model done for the Australian government the authors assume Chinese barriers in agriculture have the following tariff equivalents: Wool 15 percent, Sugar 25 percent, OilSeeds 13 percent, Cereals 3 percent, Wheat 30 percent, processed rice 10.6 percent. Source: Philip ADAMS Mingtai FAN Ronglin LI and Zhaoyang ZHENG *An Independent Report Prepared for: The Australia-China FTA Feasibility Study* The Centre of Policy Studies Monash University 2 March 2005

labor intensive manufactured goods. In the textiles and clothing sector, Australian average tariffs are 9.1 percent and there are 234 tariff lines with rates of between 16 and 20 percent, and 387 between 6 and 10 percent; in footwear there are 4 lines between 16 and 20 percent and average rate of protection of 5.6 percent.²⁷

The fact that China is willing to conclude FTAs with these two developed countries that are highly competitive agricultural producers is very significant since it indicates a willingness to contemplate major adjustments in agriculture while also indicating these countries willingness to contemplate free trade in labor-intensive manufacturing.

Others. China has also launched talks with India and Pakistan. New Delhi does not quite share the enthusiasm for a conventional FTA although it is willing to talk about cooperation. But Pakistan and China have signed a framework agreement, implemented an early harvest and Pakistan has provided China with the requisite market economy status. China is also discussing FTAs with many other potential partners in Latin America (Brazil, Peru), South Africa, the Gulf (GCC), Iceland, Asia (Korea) and with regional groupings such as APEC and East Asia (Asean plus three),

Implications.

China has numerous goals in signing these agreements. One immediate concern is to use them to obtain market status recognition and relief from being subject to special safeguards. -- Ironically China is using these discriminatory agreements as a way to *remove* the discrimination to which it has been subjected at the WTO. A second motive is to secure access to important raw materials— many of the countries

²⁷source: http://www.dfat.gov.au/geo/china/fta/feasibility_3.pdf

are major suppliers of minerals (Chile-copper, Australia -- iron-ore and uranium, and GCC—oil). A third is to solidify its relations and influence both inside and beyond the East Asian region and a fourth, the most basic, is to gain improved market access for its exports which as labor –intensive manufactured and agricultural goods are often subject to high tariff protection. Individual agreements are also used to achieve specific goals. For example, the Hong Kong and Macao agreements help underscore the privileged relationship between the Mainland and these economies and ensure that despite their differences measures such as anti-dumping and countervailing duties could not be used to segment them. In addition these agreements were used to implement specific joint initiatives and signal clearly that Beijing would permit increased state owned banks to move some of their operations to Hong Kong.

China is well aware of concerns that it is trying to dominate East Asia and/or close it to outsiders, and it has gone to great pains to allay such fears. It is particularly reluctant to appear domineering in its interactions with Asean and it prefers that ASEAN take the leading role in the bilateral relationship. China also does not want to be seen as building a fortress Asia. Consider this official statement:

“We should continue to support ASEAN in playing the leading role in East Asia cooperation. On the other hand, we should give due consideration to the legitimate interests of the non-East Asian countries in this region, so as to gain their understanding of and support for East Asia cooperation.”²⁸

In general, China’s approach to FTAs has been very pragmatic. It has shown a willingness to negotiate with countries individually and in groups (e.g. Asean and

²⁸ “Be Open and Inclusive And Achieve Mutual Benefit and Common Progress” Statement by Premier Wen Jiabao at The First East Asia Summit Kuala Lumpur, Malaysia, 14 December 2005 <http://www.fmprc.gov.cn/eng/topics/wjbfw/t228275.htm>

Asean+Korea+Japan) with developed (new Zealand and Australia) and developing countries and with those that are heavily specialized in agriculture (New Zealand and Australia), manufactured goods (Asean, South Korea) and services (Hong Kong). It has been focused on East Asia but also quite willing to deal with countries in Latin America, South Asia, and Africa. It has sought to signal that its interests are global.

The agreements have not followed a single template. Some have included goods, services, investment and cooperation (e.g. Hong Kong, Macao), others cover only goods (e.g. Chile), while some have started with goods liberalization with the intention to add services and investment later. (e.g. Asean). Several have been launched with an early harvest in which some liberalization has come into effect as soon as talks have commenced. The deepest agreements thus far are with Hong Kong and Macao, although even these do not cover issues that are part and parcel of agreements that are typically signed by the US (e.g. intellectual property, labor and environment, government procurement, dispute settlement by panels) or the EU (e.g. competition policy).

Stumbling blocs? These Chinese initiatives raise several concerns that are traditionally mentioned in debates about regional trade arrangements. The first is the concern that these regional arrangements are likely to undermine the multilateral trading system. This fear is misplaced. If (and this is an important qualification) they do achieve liberalization in “substantially all trade” FTA agreements that involve China are likely to *hasten* global liberalization. China has not insisted on covering services and investment in its agreements, but its agreements do include liberalization in most merchandise products Since China is such a competitive supplier of labor intensive manufactures, for

most countries, an FTA signed with China is very likely to be trade-creating on the import side. *Indeed, any country that adjusts domestically to Chinese competition is most likely to require little additional adjustment before it opens up to developing countries as a whole.* (The same would be true of countries opening up in services mode four –the movement of natural persons if this is included in agreements.) If China is able to sign FTAs with the Asian Pacific region, this region will be readily positioned to extend this liberalization to the rest of world.

A similar argument holds for those signing FTAs with the US with respect to services and investment. The US has insisted on deep agreements that cover services with a negative list and investment in addition to trade in goods including agriculture. Any country that signs with both China and the US could surely extend these benefits to the rest of the world without major additional dislocation.

The dominoes appear to falling. Each time China concludes an FTA with another significant trading partner, it puts pressure on others to preserve their access to the world's most rapidly growing market. In numerous sectors, China's MFN tariffs remain significant and thus FTAs could give producers of those products a significant competitive advantage. Likewise, each time China succeeds in obtaining preferential access to another market it adds to the pressure for others who sell in *that* market to obtain similar access. Korea and Japan for example, reacted to the agreement between China and Asean by proposing FTAs of their own with Asean – something they probably would not have done before.²⁹

²⁹ The Korea International Trade Association (KITA) said the China-ASEAN FTA, which will come into force Wednesday, is expected to create the world's largest economic bloc, with bilateral trade amounting to US\$1.2 trillion.

The FTA between Korea and ASEAN is still being finalized. It is expected to be implemented this year and remove duties on 80 per cent of goods traded by 2009. Korea and ASEAN have also pledged to conclude negotiations on liberalization in services and investment by the end of this year. Korea also has FTAs with Chile and Singapore and is seeking similar deals with several Latin American and other countries.

Currently, Japan is reported to be in the process of developing a concerted response to the pressures it is feeling from the Chinese and US initiatives. It is developing new policies with respect to agriculture and the movement of labor and planning a host of additional agreements to preserve its competitive position.³⁰ It appears that powerful forces of competitive liberalization are operating effectively.

Fortress Asia? A second, related concern is that East Asia could become a “fortress” in which barriers are raised or at least not lowered with respect to the rest of the world. China is, however, clearly willing to negotiate with countries outside the region. Indeed this is true of the rest of Asia as well. The countries in the Asia Pacific are global traders and there is no evidence that they are confining their FTAs to the region. Instead, they are actively scouring the globe to find FTA partners. Singapore has FTAs with the US and a host of countries outside the region.³¹ Likewise Thailand, Malaysia and

The pact will cause disadvantages such as high tariffs for South Korean industries such as petrochemicals, textiles, shoes and electrical and electronic products, the KITA said.

More than 21 per cent of South Korean exports to China will be subject to tariffs over 10 percentage points higher than those for China-bound ASEAN shipments in 2010, when the FTA is fully implemented, the KITA said. The FTA will impose no duties on more than 90 per cent of the trade between China and ASEAN members by that time.

³⁰ Japan has reached Agreements for Economic Partnership Arrangements with Philippines, Malaysia and Thailand. It is negotiating with Korea, Asean, Indonesia, and engaged in collaborative research with Chile, India, Australia, Switzerland. And in talks in Asean plus 3.

³¹ Singapore’s government webpage lists eleven FTAs that are in place and fifteen more under negotiation. <http://app.fta.gov.sg/asp/index.asp>

South Korea are all negotiating with the United States³² and Japan has an FTA with Mexico.

Hub and spoke? A third concern is that China is going to erect a hub and spoke system in which China has access to the regional economy duty free, but the other countries do not have similar access to one another. But in fact, almost all countries in the region are now negotiating with each other. For example, Asean is negotiating with both South Korea and Japan and Australia with many countries in the region. So this fear is also misplaced.

Noodle bowl? The one concern that is legitimate is the fact that these FTAs are creating a system of overlapping agreements with respect to rules of origin and other provisions that are unnecessarily cumbersome. By proceeding piecemeal in these negotiations, there is the danger for China and its other trading partners, that trade could be enveloped in the proverbial noodle bowl of agreements. Producers could have to meet different standards and rules of origin when selling to different partners. This is an area in which the WTO and APEC have both seriously failed. In particular Article XXIV 5(b) of the GATT only states that the “duties and other regulations of commerce” once the FTA is concluded shall not be higher or more restrictive than they were before. But it does little to discipline the crafting of these to meet specific circumstances in a manner that is protectionist and inefficient. The simplest solution would be a single system of rules that would be applied by all WTO members in all preferential agreements.

Section III. Qualifications.

³² Thailand's negotiations with the US have confronted problems with respect to light trucks as well as agriculture and have become a domestic political issue.

I have argued that thus far, China has promoted trade liberalization in both the WTO and through its FTAs. However, it should be stressed that many of the FTAs have yet to be completed and thus China's trade and domestic policies remain very much a work in progress. In this final section, therefore I make four major qualifications to this conclusion.

Agreement details. First, the history of free trade agreements is a very mixed one and in thinking about their implications it is important to pay attention both to their content and their prospects for implementation. Countries enter into FTAs with very different motives. Some are genuinely interested in promoting trade liberalization and deep economic integration and view the agreements as a complement to multilateral liberalization. For the most part, for example, the United States is using FTAs as part of such an offensive strategy.³³ A second group of typically smaller countries is driven by the desire to improve their competitiveness as a location for production. It is often said that preferential trade arrangements are "second best" and that multilateral liberalization is first best. But for individual countries even better than free trade could be the combination of no barriers at home and preferential access to all foreign markets. This competitiveness motive seems to explain why Chile and Singapore have pursued these agreements so avidly. A third group of countries, however, are as yet unwilling to liberalize fully and are basically driven by defensive considerations to undertake these agreements. For these countries, there is often a temptation to conclude agreements that go by the name of FTAs but (a) take a long time to implement; (b) exclude significant amounts of potential trade in goods and services (c) have highly restrictive rules of

³³ To be sure there is resistance in the US particularly from sugar and clothing producers.

origin that limit their impacts and (d) fail to include adequate provisions for enforcement.

China basically seeks to use FTAs fundamentally to secure market access i.e. for offensive purposes and it is prepared to open its market at home to do this. But its initiatives are also being driven by political considerations and the desire to reassure other countries. Unlike the US or the EU, China does not seem to have developed a demanding comprehensive FTA template that is used with minor changes with all its FTA partners. Instead China has proceeded more opportunistically, signing agreements with quite different degrees of depth and coverage. In part this is because China is using FTAs as much as an instrument of foreign policy as an instrument of trade policy.³⁴ This means that where China's partner is willing to contemplate full liberalization in the context of a deep integration agreement, the result could be trade creation on a large scale. Indeed that would appear to be the implication of the types of agreements being aimed at by the Australian and New Zealand governments. In negotiations with countries that fall into the defensive category, however, some of the agreements that are actually concluded could be quite limited and there may be less there than meets the eye.

Chinese implementation. A second key issue relates to the institutional capacity to ensure that the agreements China signs are actually implemented at home. This holds with respect both to China's WTO and FTA commitments. The United States Trade Representative for example publishes an annual report on Chinese WTO compliance and it is filled with complaints of compliance failures. The most recent report for example is

³⁴ The greater flexibility in these agreements may reflect domestic decision-making differences. In the case of the US, agreements must get through the congress.

101 pages long.³⁵ It is particularly concerned with the still incomplete transition from a state-planned economy. Other concerns include: the lack of enforcement of intellectual property laws, the continued use of industrial policies in sectors such as auto-parts, steel, and high-tech, regulatory intervention to support domestic enterprises, export restrictions on coke, the use of standards to favor domestic high tech producers and sanitary and phyto-sanitary standards to favor domestic farmers. Nonetheless, the USTR report does acknowledge that China has made great strides towards coming into compliance and it is surely the case that trade agreements make it more likely that these issues can be resolved.

Loss of competitiveness. A third key qualification relates to the continuation of China's competitiveness and its impact on Chinese domestic politics. It seems clear that the competitiveness of its traded goods sector has clearly facilitated China's adjustment to its WTO accession and contributed significantly to the character of the trade policy that I have described in this paper. China is basically eager to erect a legal and political superstructure to ensure its access to key inputs and markets and it is prepared to expose its domestic firms and farmers to increased foreign competition in order to do so. Nonetheless, even with the success it has enjoyed in recent years, domestic tensions have arisen with respect to the dislocation caused by the spread of the market economy.

There is a widespread view that the Chinese currency is seriously undervalued and there are strong external political pressures for a substantial appreciation.³⁶ The

³⁵ United States Trade Representative, *2005 Report to Congress on China's WTO Compliance*. GPO Washington DC: 2005.

³⁶ See "Clash of Titans" by C. Fred Bergsten. *Newsweek*, International Edition April 24 2006. Morris Goldstein, "Reminbi Controversies" Paper prepared for the Conference on Monetary Institutions and Economic Development Cato Institute November 3, 2005 and Morris Goldstein and Nicholas R. Lardy, "What kind of Landing for the Chinese Economy? Policy Briefs in International Economics Number PB04.7 Institute for International economics November 2004.

verdict of overvaluation seems supported by China's very large current account surplus of about 5 percent of GDP in 2005 and its significant accumulation of foreign exchange reserves over the past few years. In March 2006, these amounted to \$853.7 billion surpassing the reserves held by Japan and making Chinese holdings the world's largest. There is considerable debate over the appropriate course of action to deal with this issue, and a discussion here is beyond the scope of this paper. However, for our purposes it should be recognized that if a significant appreciation of the renminbi was to undermine Chinese competitiveness, the broad thrust of the policies described here could be adversely affected. Domestic protectionist pressures would surely increase and China would be considerably less eager to pursue reciprocal free trade agreements if it was less confident in its ability to compete. Whatever the costs of China's exchange rate policies might have been, therefore, the liberal nature of its recent trade policies should be counted among its benefits.

Hyper-competitiveness. On the other hand, there could be problems abroad, if China becomes too competitive and protectionism abroad could offset Chinese liberalization at home. It could also undermine the application of MFN treatment. In both the United States and the European Union for example, the very large bilateral trade deficits with China have heightened trade frictions. The surge in Chinese clothing exports in 2005 when the Multi-fiber Agreement expired, led to the use of special safeguards in both economies. While these were legal, they are certainly discriminatory.

In many developing countries, the highest non-agricultural tariffs are placed on precisely the labor-intensive products in which China specializes. So while China's trade policies are a force for a more liberal trading order, China's trade performance exerts

countervailing pressures in other countries. Some may rise to the challenge, but others could become even more reticent to embrace global engagement.

Table A1: Distribution of submissions over areas and issues (2003)		China				W
		DDA	Ind.	Joint	Total	
			48	17	65	
Ruling Bodies						
WT/MIN (03)/	Ministerial Conference, Doha	X	1	4	5	
WT/GC/	General Council		1	5	6	
TN/C/	Trade Negotiations Committee	X	1	1	2	
Agriculture						
G/AG/	Committee on Agriculture			2	2	
TN/AG/	Committee on Agriculture - Special Session	X	1		1	
G/SPS/	Committee on Sanitary and Phytosanitary Measures		3		3	
Non-Agriculture Market Access (NAMA)						
G/C/	Council for Trade in Goods (except trade facilitation)		1		1	
TN/MA/	Negotiating Group on Market Access	X	1		1	
G/MA/	Committee on Market Access		1		1	
G/RO/	Committee on Rules of Origin					
G/VAL/	Committee on Customs Valuation		1		1	
G/LIC/	Committee on Import Licensing		1		1	
G/IT/	Committee of Participation on the Expansion of Trade in IT prod.					
G/TBT/	Committee on Technical Barriers to Trade		3		3	
G/TRIMS/	Committee on Trade-Related Investment Measures		1		1	
G/STR/	Working Party on State Trading Enterprises					
Rules						
TN/RL/	Negotiating Group on Rules	X	4	2	6	
G/ADP/	Committee on Anti-Dumping Practices					
G/ADP/AHG/	Committee on anti-Dumping Practices – WG on Implementation					
G/SCM/	Committee on Subsidies and Countervailing Measures		10		10	
G/SG/	Committee on Safeguards		2		2	
WT/REG/	Committee on Regional Trade Agreements					
GATS						
S/C/	Council for Trade in Services		2		2	
TN/S/	Council for Trade in Services – Special Session	X	1	3	4	
S/CSC/	Committee on Specific Commitments					
S/FIN/	Committee on Trade in Financial Services					
S/WPDR/	Working Party on Domestic Regulation					
S/WPGR/	Working Party on GATS Rules					
TRIPS						
IP/	Council for TRIPS		3		3	
TN/IP/	Council for TRIPS - Special Session	X				
Singapore Issues						
WT/WGTI/	WG on Relationship between Trade and Investment	X	2		2	
WT/WGTGP/	WG on Transparency in Government Procurement	X				
WT/WGTCP/	WG on Interaction between Trade and Competition Policy	X	2		2	
G/C/	Trade facilitation (dedicated meetings of the General Council)	X				
Development						

WT/COMTD/	Committee on Trade and Development			
TN/CTD/	Committee on Trade and Development - Special Session	X		
WT/BOP/	Committee on Balance-of-Payments Restrictions			
WT/WGTTT/	Working Group on Trade and Transfer of Technology			
WT/TDF/	Working Group on Trade, Debt and Finance			
Trade and environment				
WT/CTE/	Committee on Trade and Environment			
TN/TE/	Committee on Trade and Environment - Special Sessions	X	2	2
TN/DS/	DSU Review		4	4

Source: Nordstrom.

