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The Political Economy of an Asia Pacific Free Trade Area: A China Perspective

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APEC has long been relevant for China's economic diplomacy although its significance has been relatively weakened since China's accession to the WTO in 2001. However, China still attaches great importance to APEC activities because the "APEC approach" that stresses concerted unilateralism, voluntarism and flexibility provides a unique means of regional cooperation on an experimental basis. As such, APEC can serve strategically for China to implement its Asia Pacific foreign policy in the long run. Meanwhile, with the rapid proliferation of regional trade agreement and free trade agreements (RTAs/FTAs) in the region, China has also started to set up its own RTAs/FTAs network in the manner of a hub-and-spoke system. Among many proposals, the East Asian Free Trade Area (EAFTA) was particularly favored by Chinese leaders, in contrast to the ambiguous idea of Free Trade Area of the Asia Pacific (FTAAP), which was brought forward and widely advocated by the APEC Business Advisory Council (ABAC). On the one hand, there is little doubt that further trade and investment liberalization and facilitation with institutional reforms and a binding treaty would benefit China in terms of enhancing welfare and structural changes. But, on the other hand, it is uncertain whether the proposed FTAAP would challenge China's prevailing strategy for APEC, given the expected institutionalization of the process. Additionally, economic issues, such as the protection of sensitive sectors, and political issues like the US-China relationship and status of Taiwan, make it more complicated for China to hold a positive attitude towards the FTAAP proposal.

Against such a background, it is important to have an insight of China's policy towards the FTAAP from a political economy perspective. This paper aims to review the current Chinese overall strategy and policies towards APEC and regional agreements, and extrapolate the likely position that China would have for the proposed FTAAP based on a political economy analysis of the benefits and costs of the agreement.

Part I will briefly depict China's trade and economic relations with other APEC member economies in terms of trade, foreign direct investment (FDI), balance of payment and trade barriers. Part II reviews recent Chinese trade policy focusing on its development of an RTAs/FTAs network. Parts III and IV conduct a cost-benefit study of the FTAAP by probing the gains, impediments, and concerns China would have in joining the agreement. Finally, Part V concludes with an analysis of some possible scenarios.

I. China's economic relations with other APEC members

The Asia-Pacific region is the most important region for China in terms of economic and trading activities. In 2004, 72% of China's exports and 68% of imports were with other APEC economies.ⁱ The APEC region is also vital in terms of foreign investment with 70% of China's FDI inflows coming from the regionⁱⁱ. Over the past decade "triangular trade" between China, other East Asian economies and North America (the US in particular) has

^{*} *The paper does not represent any standpoint of the Chinese government and the author's home institutes. The author therefore bears sole responsibility of expression in the paper.*

emerged that makes up much of China's intra-regional trade in the Asia Pacificⁱⁱⁱ. It means that China is exporting consumer goods and semi-finished manufactures to the US market, while importing raw materials, intermediary goods and capital goods from the region and then processing them with relatively low value-added. In line with such a large volume of trade flows, there are also huge FDI inflows into China, which makes China the third largest trader and largest developing country recipient of FDI in the world.

One of the great concerns for China's trade relations with APEC partners is a trade imbalance, particularly with its largest export market – the US^{iv}. China has been charged as the main culprit for global imbalances and immediate actions are called upon in order to make necessary adjustments (Bergsten, 2005c). However, China explains that the US trade deficit with China is not only overstated due to some technical reasons, such as rules of origin and transshipment via Hong Kong, but also a “natural” result of “triangular trade” in the region, which moves the U S - East Asia trade deficit to a U S - China trade deficit, as well as the export control policies imposed by the US government against China.

Meanwhile, trade frictions between China and its trade partners have increased since China's accession to the WTO, many of which are APEC member economies. Regarding WTO disputes, China has been involved in 49 cases in total (including one case as a respondent, one case as a complainant, 47 cases as a third party to, WTO, 2006). China is also currently subject to the greatest number of anti-dumping actions among all WTO Members^v. Furthermore, Chinese enterprises and exporters have expressed great concerns over all kinds of technical barriers and other safeguard measures particularly against China's exports, such as agricultural goods, electronic appliances, toys, footwear, rubber products, and textiles and clothing. Therefore, further trade liberalization initiatives in the Asia-Pacific are expected to ease imbalance, disputes and crises between China and its partners in the region.

II. China's current trade policies

Unilateral trade liberalization and fulfilling the commitments of WTO accession^{vi}

China has been undertaking significant unilateral trade liberalization since the early 1990s in order to accede to the WTO and meet the APEC Bogor Goals. It has taken major steps to revise and update a large number of laws, and to streamline its trade policy regime to conform to international norms. In accordance with the WTO accession commitments, the average tariff level has been reduced from 15.3% at the time of accession to 9.9% in 2005. In addition, all China's tariffs are bound, and applied rates and bound rates are exactly the same. All non-tariff measures including import quotas, import licenses and import tendering had been eliminated by 1 January 2005 with a few exceptions that are also scheduled to be abolished.

On services, China's accession commitments were more extensive than those of other developing countries. Of the 160 services sectors and sub-sectors under the WTO classification, China has opened more than 100, accounting for 62.5%, close to the level of commitments made by developed members. The level of market access and national treatment for foreign services suppliers has also been significantly increased.

Notwithstanding these achievements, China still faces numerous challenges to enhance transparency in policymaking and implementation, dismantle indirect intervention by the authorities, and tackling many “behind-the-border” issues. Many concerns have been raised by other WTO members about anti-dumping and countervailing duties, standards, sanitary and phytosanitary (SPS) measures, export taxes and value-added tax (VAT) rebates. Further measures to liberalize the service sector include relaxed ownership, entry and geographic requirements and a deepening of regulatory and institutional reforms. Several questions have also been raised on the issue of [‘state directed’] investment in certain sectors, particularly in the steel and automotive sectors, as well as the drafting of the Competition Law and enforcement of intellectual property rights.

Participating in the WTO Doha Round

As a member of the “Five Interested Parties Plus” group (11 countries in total), China is an active player in the current negotiations of WTO Doha Round. China supports the establishment of a fair, more open and dynamic multilateral trading system by enhancing market access, balanced rules, and well-targeted, sustainably financed technical assistance and capacity-building programmes. Up to now, China has submitted more than 30 proposals and position papers in the negotiations, which played a positive and constructive role in advancing the negotiations (Chinese Government, 2006). China affirms that the negotiations should take full account of the level of development and capacity of developing members and should put special and differential treatment into effect to allow them to implement development strategies that suit their own conditions. It also promises to provide assistance to LDCs, including improved market access and debt forgiveness.

As a member of both G-20 and G-33, China supports the elimination of all kinds of export subsidies, the substantial reduction of trade-distorting domestic support, and significant reductions of tariff peaks and tariff escalation of agricultural products. Meanwhile, it stands that there should be an effective solution to the specific concerns of developing members related to special products and the special safeguard mechanism.

In respect of non-agricultural market access (NAMA), the Chinese Government supports the reduction of high tariffs by using the Swiss Formula with dual coefficients for developed and developing members respectively to fulfill the principle of “less than full reciprocity”. In the negotiations, it also submitted the proposal of a tariff reduction formula, which laid the foundation for the “Chairman’s Formula” (“Girard Formula”).

In the negotiation of services, China hopes that the export interests of developing members can be recognized, particularly in the field of Mode 4 (movement of natural persons), and that the negotiations are able to strengthen their capacity to participate in world trade in services. China is one of a group that submitted their initial and revised offers at the very early stage of negotiations.

Moreover, China stresses that the negotiations on rules should contribute to further clarify and improve WTO rules, promote trade facilitation and reduce the abuse of trade remedy measures, particularly antidumping measures against developing members. It has raised several proposals on the issues of customs procedure, antidumping and fishing subsidy.

Finally, China insists that special concerns of newly acceded WTO members should be recognized and respected, taking account of the extensive commitments they have already

made and the heavy adjustment pressures in the transition period. It also succeeded in defending its status as a “developing member” as a whole, and therefore is able to enjoy many special and differential treatments regarding “special (non-agricultural) products”, *de minimis* exemption of agricultural goods, and favorable disciplines related to state trading enterprises (STEs).

China’s RTAs/FTAs development and policy evolution

China has sped up building its own RTAs/FTAs network since 2001 when China signed its first regional trade agreement with other members of the Bangkok Agreement. This is a most important departure from its traditional trade policy which solely relied on the multilateral trading system and adhered to its non-alliance strategy. Currently, China has concluded or been in the process of negotiating ten RTAs/FTAs involving 32 countries and regions in Asia, Africa, Latin America and South Pacific (Table 1). For 2005, China’s trade volume with these countries and regions was US\$ 344.5 billion, accounting for one fourth of China’s total trade for that year^{vii}. China also started official joint feasibility studies on FTAs with India and Iceland. Other countries, particularly the Republic of Korea and Japan, are also candidates for an RTA/FTA, although the feasibility study still remains at the preliminary academic stage.

Table 1. China’s participation in RTAs/FTAs (up to April, 2006)

	Type	Year	Latest development	Areas and issues covered
<i>RTAs/FTAs already signed</i>				
China-Hong Kong	CEPA	The agreement was signed on 29 June 2003, and entered into force on 1 January 2004.	A Supplementary Agreement was signed on 27 October 2004, and has been implemented since 1 January 2005.	<ul style="list-style-type: none"> •tariff and non-tariff barriers of goods •trade in services •investment •standards conformity •dispute settlement
China-Macao	CEPA	The agreement was signed on 17 October 2003, and entered into force on 1 January 2004.	A Supplementary Agreement was signed on 29 October 2004, and has been implemented since 1 January 2005.	<ul style="list-style-type: none"> •tariff and non-tariff barriers of goods •trade in services •investment •standards conformity •dispute settlement
Bangkok Agreement	Regional PTA	China acceded to the agreement on 12 April 2001, and started implementing concessions on 1		reduction of tariff in goods

China-Pakistan	Bilateral PTA	January 2002. The agreement was signed on November 2003.	The early harvest agreement was signed in April 5, 2005, and entered into force on 1 January 2006.	<ul style="list-style-type: none"> •reduction of tariff in goods •Pakistan recognized China as a market economy.
China-ASEAN	Regional FTA	The agreement was signed on 4 November 2002, and entered into force on 1 July 2003.	<ul style="list-style-type: none"> •Early harvest agreement was implemented from January 1, 2004. •The agreement on trade in goods and dispute settlement mechanism entered into force on 1 January 2005. •Tariff reduction process started from July 20, 2005. •Trade in services and investment are still under negotiation. 	<ul style="list-style-type: none"> •tariff and non-tariff barriers of goods •trade in services •investment •customs procedures •mutual recognition •ASEAN member states recognized China as a market economy.
China-Chile	Bilateral FTA	The agreement was signed on 18 November 2005.	<ul style="list-style-type: none"> •The agreement on tariff elimination will start to be implemented in the second half of 2006. •Negotiations on trade in services and investment are to start in 2006. 	<ul style="list-style-type: none"> •national treatment and market access for goods •rules of origin •trade remedies •SPS •TBT •dispute settlement •Chile recognized China as a market economy.

RTAs/FTAs under negotiation

China-New Zealand	Bilateral FTA	The negotiation was launched on November 19, 2004.	Six rounds of negotiation have been held.	New Zealand has recognized China as a market economy.
China-Australia	Bilateral FTA	The negotiation was commenced on 18 April, 2005.	Four rounds of negotiation have been held.	Australia has recognized China as a market economy.
China-GCC	Regional FTA	The negotiation was launched on July 6, 2004.	Three meetings of Trade Negotiation Committee have been held.	
China-SACU	Regional FTA	The negotiation was launched in June 2004.		SACU granted China market economy status.

RTAs/FTAs under joint feasibility study

China-India	Bilateral FTA	A feasibility study was started in April 2005.		
China-Iceland	Bilateral FTA	On 17 May 2005, China and Iceland agreed to undertake the study.		Iceland has recognized China as a market economy.

Academic Feasibility Study

China-R.Korea-Japan	Regional FTA	-	-	-
China-R. Korea	Bilateral FTA	-	-	-

Notes:

CEPA refers to "Close Economic Partnership Agreement".

Other members are India, Republic of Korea, Bangladesh, Sri Lanka and Lao PDR.

Gulf Cooperation Council (GCC) includes the following members: Saudi Arabia, United Arab Emirates, Kuwait, Oman, Qatar, Bahrain.

Southern African Customs Union (SACU) includes South Africa, Botswana, Lesotho, Swaziland and Namibia.

Source: Antkiewicz and Whalley (2004), Hufbauer and Yee Wong (2005), WTO (2006), Zhao Jie and Han Yi (2005)

China states that it is pursuing and will continue to expand RTAs/FTAs in an active and steady manner with various forms, focusing on specific partners and issues (Zhao Jie and Han Yi, 2005). It also believes that regional trade and economic cooperation is a useful supplement to the multilateral trading system and helps push forward global trade liberalization and investment facilitation, and at the same time, it should not be done at the expense of the multilateral trading system (Chinese Government, 2006).

There are a number of distinguishing features that make China's RTAs/FTAs different from those of other countries. First, following a pragmatic approach to serve particular bilateral or regional commercial and strategic interests, China does not adhere to a common template for each RTA/FTA. This approach is reflected in the very diverse trade agreements, ranging from the Closer Economic Partnership Arrangements (CEPAs) with Hong Kong and Macao, which contain highly concrete terms and comprehensive issues covered, to the agreements with New Zealand and Australia, which are mainly statements of intent with only broad aspirations for mutual cooperation. Second, instead of the one-off conclusion of a comprehensive treaty, many Chinese RTAs/FTAs are negotiated and implemented in a piecemeal approach from the initial Early Harvest program that aims to eliminate selected tariffs on goods to further extended topics including services, investment and trade facilitation. It will contribute to the confidence-building process in which all parties are able to benefit from trade liberalization from the start. Finally, it is also notable that many agreements exclude sensitive sectors and issues that seem quite difficult to deal with in short term, such as intellectual property protection, special sectoral liberalization, environment and labor standards, and dispute settlement mechanism. In spite of their relatively low-quality, these agreements can well serve both commercial considerations and domestic political interests of both parties with "constructive ambiguity".

Why is China actively pursuing RTAs/FTAs? What are the specific political and economic motivations behind China's endeavors to expand its RTAs/FTAs network so fast? The foremost driving force comes from the new wave of RTAs/FTAs proliferation around the world since the early 1990s. Up to December 2004, about 230 countries and regions had notified to the WTO at least one regional trade arrangement. They cover most of WTO members and intra-regional trade accounts for over half of total world trade volume (World Bank, 2004). Noticeably, two of the largest developed economies, namely the US and the EU, have sped up the extension of their own RTAs/FTAs network in recent years. In addition, since the late 1990s many Asian nations shifted from a single-minded dependence on the multilateral trading system to an obvious attempt to consider RTAs/FTAs as part of their trade policy strategy. Under such circumstances, the only response open to China was to launch its own RTAs/FTA initiatives to avoid being excluded from existing regional arrangements and avoid trade diversion.

Secondly, RTAs/FTAs will create a more favorable, stable and foreseeable trade environment for China. China will benefit from better market access in selected economies like ASEAN and India, whose billions of consumers and dynamic economies represent a large potential market for Chinese competitive exports. Moreover, China is increasingly becoming a source of FDI and M&As and the RTAs/FTAs could be an important vehicle for attracting Chinese investment for overseas markets. Chinese bilateral and regional arrangements may, like all other RTAs/FTAs, also manage to lock in protectionism of partners so as to avoid changeable trade barriers in the future.

Thirdly, RTAs/FTAs can be important instruments of commercial diplomacy to realize China's vision of geopolitics and global strategy. Specifically, the Closer Economic Partnerships Agreements (CEPAs) with Hong Kong and Macao can be regarded as experimental models to institutionalize closed economic partnerships under the "One Country, Two Systems" regime. This approach may give some further indications of an acceptable solution to unify Taiwan economically with the mainland. The ASEAN-China FTA is a typical example of implementing China's good-neighbor foreign policy to mitigate those countries' fear of Chinese economic growth and fierce export competition. Other trade

agreements such as those with Pakistan, India, Chile and the South Africa for instance, also demonstrate China's diplomatic endeavors to initiate or consolidate strategic partnerships and promote South-South cooperation with selected countries in different continents.

In addition, China will benefit from more assured supplies of energy and crucial raw commodities under RTAs/FTAs, which partly helps to fulfill national security goals for natural resources. Such a motive is particularly embodied in the bilateral agreements reached between China and Australia, ASEAN and the Gulf countries for crude oil, iron ore and other essential primary materials^{viii}. The agreements also help to minimize the risk of supply shortages in the event of commodity price increases.

Another significant affect of China's FTAs is to remove those unfavorable results stemming from the legacy of discriminatory clauses in its protocol of accession to the WTO. Among others, the non-market economy provision in determining dumping and transitional product-specific safeguard mechanism had tremendous negative impacts for Chinese labor-intensive and low-skill product exports. Both the Chinese government and export enterprises have long been plagued by the struggle to get full recognition of market economy status. Therefore, FTAs are particularly attractive to China as it has succeeded in pressing partner countries to grant China full market economy status in the negotiations. Such outcomes are well-reflected in the agreements with several countries including Australia, New Zealand, Iceland, ASEAN, Chile, Pakistan and SACU (as illustrated in Table 1). It can be anticipated that more RTAs/FTAs negotiations will be launched to systemically rectify the "unfairness" which China thinks exists in bilateral trade relations.

It is also argued that China is keen on using RTAs/FTAs to position itself as a free trader when negotiating with industrial countries (Hufbauer and Yee Wong, 2005). The treaties with Australia, New Zealand and Iceland can be considered as a first step to initiate such a process, although it is well-recognized that these are only small developed nations and the real significance of agreements is still doubted. In other words, those "warm-up" agreements are expected by the Chinese government to bring ample demonstration effects on other industrial countries, particularly on the US and EU, in the future.

Eventually, RTAs/FTAs are indispensable vehicles to assist the central government to advance trade liberalization, domestic deregulation and industrial restructuring reforms. While the WTO Doha Round seems to have faltered, RTAs/FTAs can provide new momentum to accelerate economic reforms, particularly in sensitive import-competitive sectors like automotive, banking, telecommunication and transportation where strong interest groups and local governments resist further reforms.

III. Potential benefits of joining FTAAP

Market access, welfare and dynamic effect

As described in the Section I, most Chinese foreign trade and FDI is transacted with economies in the Asia-Pacific region, whereas the main trade barriers and trade frictions are also in the region. Consequently, through the gradual elimination of restrictive trade and investment measures of all countries and regions concerned, the FTAAP may offer China more opportunities to tap overseas markets by taking advantage of its international competitiveness so as to achieve sustained economic growth. Preliminary computable general equilibrium (CGE) simulation analysis indicates that an FTAAP will deliver more favorable economic welfare for China than any other existing arrangement like the ASEAN-China FTA

and other scenarios such as ASEAN-China-R. Korea-Japan FTA and APEC non-discriminatory liberalization (APEC MFN) (Scollay, 2004). My own estimation based on the gravity model also shows a large amount of welfare gains for China if it participates in the FTAAP (Sheng Bin, 2006). These positive economic effects could be even larger if the model captured other elements neglected in the static analysis, such as structural change, externalities, increasing returns, scale effects, and technological progress.

However, any quantitative prediction should be treated with caution because the result depends upon the assumptions, parameters and data selected for the study. More importantly, it should be noted that according to the political economy of trade policy, a considerable part of welfare gains comes from the increase of consumer surplus, which in practice has only limited weight in Chinese government objectives. On the contrary, the losses of producers, particularly of state-owned enterprises (SOEs), which would be incurred by joining the FTAAP, may be given greater weight by the government. Therefore, just like all other cases of trade liberalization, the FTAAP is essentially an “economically right, but politically hard” decision for the central government.

Strengthening APEC institutionalized trade liberalization

The launch of an FTAAP would revitalize APEC itself to pursue trade and investment liberalization, and provide on-going momentum to achieve the Bogor Goals. Since the failure of the Early Voluntary Sector Liberalisation (EVSL) there have been increasing doubts whether APEC will be able to achieve the Bogor Goals. It is also argued that the prevailing APEC process may not be suited to deliver reciprocal trade liberalization commitments. Hence, a more efficient and institutionalized approach, an FTAAP for example, may strengthen the trade liberalization process in APEC. It is also noted that within the APEC process, the emphasis now appears to be placed almost exclusively on the WTO negotiations as the vehicle for achieving APEC’s liberalization objectives. Outside the APEC process, APEC economies have turned decisively and increasingly towards preferential agreements as the vehicle for pursuing their liberalization goals (Scollay, 2004). Therefore, an FTAAP is urgently needed to boost trade liberalization in the APEC framework and re-divert negotiation resources from sub-regional arrangements to the APEC process. Chinese officials and economists have expressed their dissatisfaction with sluggish APEC trade liberalization on many occasions, and many of them also agree that concrete measures would intensify the APEC process on trade liberalization. However, it is not clear launching an FTAAP would be the best choice for them.

FTAAP and proliferation of RTAs/FTAs

One of the strong arguments in support of the FTAAP proposal is that a single Pan Asia-Pacific trade pact would effectively end the proliferation and explosion of RTAs/FTAs. (Bergsten, 2005b; Scollay, 2004). At the same time, the “spaghetti bowl” and the discriminatory effects associated with the current “kaleidoscope” of sub-regional arrangements can also be eliminated. In this context, there would be no further need for China to continue pursuing its RTAs/FTAs network if an FTAAP were concluded, and hence its regional trade policy could be streamlined and the administrative resources needed for negotiations could be saved.

In spite of such an advantage, there is still a high possibility that Chinese bilateral and regional FTAs will coexist with the FTAAP for some time. One explanation is that the FTAAP negotiation would not be an instantaneous process, and consequently there will

inevitably be a period in which the FTAAP and FTA negotiations will proceed in parallel. Moreover, China is not likely to completely abandon new FTA negotiations in case of the failure of the FTAAP. China may still prefer RTAs/FTAs which contain special terms to achieve designated goals or efficiently cope with the issues of both parties, particularly in the scenario where the FTAAP agreement concluded is of a low quality. Finally, China may be reluctant to confine itself into a single template of an FTA which is not able to show preferential and differential treatments for selected partners.

FTAAP and United States.-China relations

As two super economies in the region, China and the US are experiencing a series of intractable problems in bilateral relations, and any problem which is not tackled properly is very likely to trigger a crisis. Specifically, there is an imbalance between the soaring US current account deficit and the huge Chinese trade surplus. China's rigid exchange rate regime has also been heavily criticized and the US Congress is threatening to take strong measures against China as a "currency manipulator". Furthermore, the Chinese government views the US export restriction on high-tech products and components as political and ideological hostility, the restriction is considered to be partly responsible for the unsustainable US trade deficit with China. The United States has also increasingly imposed new restrictions on Chinese exports of manufactured goods using the antidumping and special safeguard mechanism. The Chinese government is also quite annoyed by the US insistence of not giving China a market economy status, even in sectoral cases. The US Congressional rejection of Chinese multinational corporations' bid for American firms and other moves to prevent China pursuit of FDI or M&A for energy supplies in overseas market are regarded as widespread fears on the part of US politicians against China's rapid growth. The bilateral relationship becomes more worrisome when political and security problems are taken into account. Among others the issue of Taiwan is the most politically sensitive. Bergsten (2005b) also argued that China is likely to perceive a series of US initiatives on economic and security affairs as a "surround China" or even "containment" strategy.

In this context, Bergsten proposed that the only solution to address these fundamental problems between the two locomotives in the Asia-Pacific is to launch FTAAP in order to subsume the China-US bilateral clash into a broader regional framework, when a bilateral FTA agreement can be hardly reached given the US domestic political environment and tremendous trade diversion effect on other Northeast Asian countries. The idea of an FTAAP could be quite attractive to China if a "high-quality" trade pact is concluded, particularly if it includes stipulations on the limited use of trade administrative protection and export controls. It will favorably provide China with a foreseeable open American market by locking-in US free trade commitments to China. Moreover, the US trade deficit with China can be possibly curbed or even reduced when the agreement induces more US exports and FDI to China.

Nevertheless, the proposed FTAAP can not be expected too much to lessen bilateral collisions because none of the problems listed above are easily touched and dealt with in a pan-regional trade agreement. They are either too particular for both parties concerned or too problematic and sensitive for all other APEC economies at the same time. Thus, the best and most efficient approach of treating the China-US relationship is not in a regional framework, but essentially through a special bilateral senior dialogue mechanism, which aims to build confidence and credibility in mutual cooperation as well as to undertake well-designed structural reforms similar to the U. S.-Japan negotiation in the 1980s.

IV. Impediments and difficulties in joining the FTAAP

WTO, DDA and FTAAP

It is strongly argued that the establishment of an FTAAP would create considerable impetus to the badly faltering WTO Doha Round negotiations and lead to a successful conclusion. Such an implication can be drawn from the catalytic role of APEC played in the 1990s in the conclusion of the Uruguay Round and ITA negotiations. Many politicians and economists are therefore earnestly advocating a similar jolt to substantially stimulate the current negotiations (Bergsten, 2005b; Scollay, 2004). In this regard, the FTAAP plays an imperative role of a “stepping stone” to full global trade liberalization. Meanwhile, the start of an FTAAP negotiation would also be an incentive for non-APEC economies to work constructively in the WTO, given the collective bargaining power of all APEC members. At the least, the FTAAP proposal can serve as an alternative means of trade liberalization across the Asia-Pacific in the event that the DDA fails. It is even argued that the FTAAP might not be necessary to be completed if the launch succeeds in bringing an ambitious result for the Doha Round (Bergsten, 2005b). In this context, the proposal of FTAAP is just used as a bargaining chip for multilateral negotiations.

Notwithstanding such seemingly convincing arguments of the FTAAP’s constructive role, there are still several suspicions of an APEC-wide FTA from the Chinese perspective. As stated above, China considers regional trade integration process as complementary to the multilateral trading system, and hence any RTA/FTA should be WTO-compatible and not undermine the multilateral trading system. In other words, any counter-productive and erosive effect of the FTAAP should be avoided. The Chinese government’s clinging to WTO principles and rules is derived from the belief that China is able to better settle trade disputes and gain a more favorable position in a multilateral framework, in which developing members can play a more important and active role. Consequently, China would not want the launch of FTAAP negotiations to be perceived as a signal that it has lost confidence and credibility in the WTO. Neither does China want to drain limited executive resources and energy from multilateral negotiations to time-consuming FTAAP negotiations. In short, China has to carefully consider if the support of FTAAP will substantially change its traditional trade policy in which the multilateral trading system remains a central tenet.

APEC approach

Many officials and economists have expressed their disappointment of the sluggish APEC trade liberalization process since the failure of the EVSL initiatives. Such an outcome is largely attributed to the current soft APEC approach which is unable to deliver the ambitious Bogor Goals. Some officials have proposed that the APEC process be restructured and institutionally reformed to offer an effective vehicle for trade and investment liberalization. To launch a FTAAP is then such an opportunity. However, others strongly defend the APEC approach saying that it has provided a unique way of maintaining cooperation among members in the past, and should continue to be adhered to. Some of them even suggest that APEC members can leave the negotiation of ambitious binding agreements to other forums like the WTO so that an FTAAP will not destroy the essence of APEC process, while others advise starting the FTAAP negotiation as a separate process, parallel to the development of APEC (Scollay, 2004).

What is the Chinese government’s stand on the impact of an FTAAP on the APEC approach? If we trace back the history of APEC’s development, it is found that China has made great contributions to formulating the APEC approach^{ix}, which is currently summarized as “concerted unilateralism” and “open regionalism”. “Concerted unilateralism” aims to

pursue liberalization, facilitation and collaboration of individual economies primarily based on voluntarism and gradualism, and complemented by sharing best practices and expertise, pathfinder initiatives and peer review pressure which is being employed as the main enforcement mechanism. As Scollay (2004) pointed out, the design of APEC process can usefully be viewed as an attempt to reconcile an Asian consensus-based approach with a North American or Anglo-Saxon approach that insists on reciprocity. To achieve “open regionalism”, China is determined not to seek to the establishment of APEC as an inward-looking, closed trading bloc, but rather prefers to progressively lower its trade and investment barriers on a non-discriminatory basis.

The APEC approach has long been relevant to China. On the outset of APEC establishment, there were hot debates over the institutional form of APEC. Australia and Japan initially intended to set up an OECD-type organization, a policy forum, while the US preferred a “New Asia-Pacific Community”, a formalized and rule-making free-trade arrangement. China has a very clear and confirmed vision of its own, that is, “APEC should keep to its nature as an economic forum and focus on promoting the regional economic cooperation”(Jiang Zemin, 1999). The simple self-defined notion has profound policy implications. The function of APEC, from a Chinese point of view, is as a consultative and consensual decision-making entity, and it is neither a venue, like the WTO, for trade negotiation and bargaining, nor an obligatory agreement like the European-approach which relies on the drafting and ratification by all participants of legally binding international agreements or treaties (Table 2). In essence, APEC is a loosely-structured and minimal institutional organization. China firmly sticks to the APEC approach, indicating that the willingness to cooperate does not imply transferring sovereignty, deepening far-reaching integration and pursuing extensive institutionalization.

Table 2 Institutional differences among APEC, WTO and EU

	APEC	WTO	EU
Who are participants and stakeholders?	inter-government, but also focusing on business and academics participations	inter-government, just beginning to communicate with NGOs	inter-government, also considering interests of social groups
How to become a formal member?	no criteria, no threshold offers	qualification review, down payment for accession	implicit criteria, approval by all members
What is institutional framework?	no treaty, only some agendas	rules, protocols and schedules	Treaties
How to reach an agreement?	consensus & dialogue	Negotiations	consensus & voting
How to make commitments?	selected menu (IAPs/CAPs)	package deal	collective actions
How effective for commitments?	voluntary non-binding	compulsory binding	compulsory binding
How are treatments between members and non-	open regionalism	MFN among members	custom union and discrimination against non-

members?			members
Is there a dispute settlement mechanism?	no	Yes	Yes
Conclusion	economic forum	multilateral system	regional integration organization

China's approach to APEC is derived from a scrutiny of internal and external political and economic factors. Notwithstanding the projected welfare gains from trade and investment liberalization and facilitation (TILF), Chinese leaders need to "control" the process to accommodate pressure groups and minimize structural adjustment costs in order to have a buffer for future domestic reforms. It can also soften the hard line of some developed members who favour the approach of comprehensiveness and uniformity by compromising "flexibility" with "comparability". China regards the approach as a "unique" collaborative approach of APEC as its own. The practice has clearly shown that this approach is so "viable and effective" that "(it is) conducive to achieving a balance of rights, interests and needs of various members" and therefore should be maintained" (Jiang Zemin, 1999).

However, the FTAAP proposal, which is, on the contrary, based on binding reciprocal commitments, will represent a fundamental and decisive departure from the commonly recognized concept of "concerted unilateralism" and "open regionalism". Hence, this critical change not only needs to be agreed on by all APEC members but also challenges China's long-term strategy for APEC.

High-quality FTAAP?

From the Chinese point of view, if negotiations for an FTAAP are launched, it would be highly desirable to reach a comprehensive and high-quality agreement. Only in this way can the Bogor Goals be achieved and the risk to world trading system be minimized. Several rules, standards or references have been made to regulate the established RTAs/FTAs. GATT Article XXIV and GATS Article V serve as a fundamental benchmarks to formulate related rules, albeit with some vague definitions and terms in clauses. Emphasizing conformity to WTO rules, the "Best Practices of RTAs/FTAs in APEC" also provides a good reference and template for APEC members to conduct RTAs/FTAs on a voluntary basis. Moreover, the PECC Trade Forum also proposed an "APEC Common Understanding on RTAs" which can be used as guidelines for RTAs/FTAs that would be consistent with the Bogor goals.

In Scollay's study paper (Scollay, 2004), a high quality FTAAP agreement is characterized as including few (or preferably no) exclusions in product or sector coverage, simple and transparent rules of origin, clear and minimal safeguard provisions, prohibition on anti-dumping measures and agreement to deal with the relevant issues via competition policy, extensive trade facilitation provisions, full coverage of government procurement, full liberalization of investment flows, and a transparent and effective dispute settlement process. If all these elements could be incorporated in the final treaty, China would undoubtedly benefit from joining the agreement, and therefore it would be likely that China would join. However, achieving a high quality agreement is highly unlikely because of the complexity of the issues as well as the number of sectors involved in the discussions. A low quality FTAAP with limited coverage and considerable exemptions will just make an APEC-wide FTA like "a new piece of spaghetti in the bowl", and such a situation can not be considered a useful contribution to both WTO and APEC.

Pressure groups and protection of sensitive industries

Another explanation of China's reluctance to join the FTAAP comes from concerns over politically sensitive sectors. So far there are several cases of exclusions or exemptions in Chinese bilateral and regional FTAs. For instance, the ASEAN-China FTA has yet to address the issue of the Chinese import restriction on palm oil, in which ASEAN countries have a comparative advantage. Chinese officials are also concerned that agricultural and dairy goods might remain a block to future negotiations with New Zealand and Australia, because China is particularly wary of adverse effects on farmers caused by radical agricultural trade liberalization. The Chinese People's Congress has repeatedly postponed review of the Anti-Monopoly Law which indicates great lobbying pressure from some SOEs, such as service suppliers of banking, telecommunication and transportation, which are stiffly opposed to free competition and further openness to foreign suppliers. All these issues and sectors that have proved difficult to negotiate in the WTO and bilateral FTAs will be just as, if not more difficult to negotiate in the FTAAP. Therefore, it is inevitable that some exclusions or exemptions would have to be accepted in order to reach agreement on an FTAAP.

Alternative scenario of EAFTA

While making significant contributions to APEC development, East Asian countries are spontaneously engaging in regional integration among themselves. This process originally derived from then Malaysian Prime Minister Mahathir's proposal for an East Asian Economic Group in the early 1990s, but it was widely considered as an anti-United States initiative to exclude the US leadership in the Asia Pacific. Then the proposal turned into a "10+3" cooperative framework including ASEAN, China, Japan and Republic of Korea in 2003. These countries have been holding regular ministerial meetings since 1998 and also successfully held the first East Asian Summit in 2005. Furthermore, many feasibility studies on a pan East Asian FTA (EAFTA) are being conducted by considering the merger of bilateral agreements between Japan-Korea and the ASEAN-China FTA, although two largest countries, China and Japan, are currently facing political tension and possible military conflict.

The idea of EAFTA has aroused great concerns for the US. It is not only worried that an EAFTA would lead to a bi-polar APEC, given the development of EAFTA, but also is feared that EAFTA could have disastrous political and commercial effects on the US (and also other non-EAFTA APEC member economies) through trade discrimination against outsiders. In this context, Bergsten (2005a) argued that only an FTAAP is able to banish the risk of disintegration of APEC by "embedding both Pacific Asia and the Americas in the Asia Pacific".

China is a firm supporter of the EAFTA proposal. It would benefit from increasing intra-regional trade and FDI flows as well as integrating into a regional production network by further eliminating trade barriers and reducing transaction costs in the region. East Asian countries could also play a more important role in the global economy under an EAFTA, and consequently provide a viable external context for China's regional integration. For China, EAFTA will also give a political expression to the new economic reality with the purpose of fulfilling "Asian interests" and "Asian values", while the institutions established since the World War II to manage global and regional affairs have long been reflected in the cross-Atlantic order. Even if the FTAAP is launched, China may continue to promote the EAFTA under the framework of "ASEAN+3", particularly in the areas that would not be covered in the FTAAP, such as currency and financial cooperation.

Treatment of Taiwan's membership

APEC is one of few forums in which both China and Chinese Taipei have memberships. Chinese senior officials and bureaucrats are often puzzled over how to confine the diplomatic activities of Taiwan in the APEC arena.. They expect that the influence of Taiwan should be minimized in political terms, and is strictly confined to economic affairs at most. Therefore, China will not anticipate the launch of FTAAP to exacerbate such a problematic issue, because it is impossible for China to negotiate and reach an agreement with a “non-sovereign state”. One scenario is that the Chinese government will attempt to insist on the exclusion of Chinese Taipei at the very beginning of negotiations, but it may face the fierce objection of Chinese Taipei and the US, if an FTAAP is negotiated in the APEC context. Another possibility is to treat Taiwan as an independent tariff territory, just like the practice in the WTO. No matter which solution is chosen, the treatment of Taiwan's membership remains a difficult topic for China and has to be decisively and cautiously addressed in the feasibility study.

Lack of executive resources for possible negotiations

As a new comer to FTA negotiations, China still faces many challenges to participate the FTAAP in terms of administrative resources. First, China is now engaging in trade negotiations in a number of dimensions, including the WTO, APEC and various bilateral or regional FTAs. FTAAP negotiations will impose an even greater work load on Chinese trade negotiators and also divert significant resource from current trade talks. Second, China still lacks experience in tackling complex issues in trade in goods, service, investment and other issues, as well as qualified negotiators with sophisticated expertise. Third, capacity building is urgently needed with sufficient funding for technical and training activities, particularly in the area of trade rules such as rules of origin, technical barriers to trade, and sanitary and phytosanitary regulations.

Transitional period and Bogor Goals

APEC's Bogor Declaration sets 2010 as the target date for full implementation of trade and investment liberalization by APEC developed economies, and 2020 as the target date for APEC developing economies. Now the first target date is impending, yet a number of challenges are confronted to achieve the ambitious Bogor Goal for developed economies, according to the APEC mid-term stocktaking report (APEC Task Force, 2005). With respect to industrial goods, the key issue is how to tackle the residual protection, including tariff peaks in selected sectors such as fish products, leather, rubber, footwear and travel goods, textile and clothing, as well as tariff escalation across manufacturing sectors, in spite of low overall levels of protection in these countries. Furthermore, antidumping and safeguard measures against exports which APEC developing economies have interests in are still prevailing on a discriminatory and discretionary basis. Restrictions or prohibitions on FDI and services are also relatively high in some developed economies. Finally, more work needs to be done to deal with “behind-the-border” issues in developed members to implement domestic regulatory and structural reforms. Therefore, if the Bogor Goals are interpreted in a dynamic manner stressing the dismantling of residual border controls and stretching to “behind-the-border” measures, APEC developed members have to pursue on-going reforms and liberalization to achieve the goal by the deadline. In this regard, Chinese officials are concerned that the launch of an FTAAP would probably dilute the dedication of developed economies on achieving the Bogor Goals or subtly delay the original target date, because the end of transitional period in the FTAAP is widely expected beyond the year of 2010.

V. Conclusion

Following its market-oriented reform strategy, China will continue to pursue trade liberalization by means of multilateral, regional, bilateral and unilateral approaches. Noticeably, in recent years, the Chinese government has increasingly looked to regionalism as a complement to its traditional reliance on the multilateral trading system. RTAs/FTAs seem more efficient in tackling special bilateral trade issues and promote economic cooperation by focusing on selected areas. Moreover, China will benefit from building its own RTAs/FTAs network by positioning itself in the center of a hub-and-spoke system and achieving non-economic goals in the game of geopolitics. In short, China's evolving strategy RTAs/FTAs strategy will have a significant impact on its attitude to the idea of an FTAAP.

From an economic perspective, there is little doubt that China would benefit from joining the FTAAP since both its main trade partners and vital trade barriers in export markets are concentrated in the Asia Pacific region. Nevertheless, Chinese support for an FTAAP would be curbed by a number of political and diplomatic elements, which are analyzed in this paper. Among others, the APEC approach, US-China relations, exclusion of sensitive sectors, the alternative proposal of an East Asian FTA and membership of Taiwan are critical questions that need careful addressing. If the Chinese authorities can not be persuaded or these problematic issues can not be handled properly, it is unlikely that China will join the FTAAP negotiation.

Finally, we will ask what are scenarios for the Chinese response to the idea of FTAAP? The forecasting is obviously difficult, much depending on Chinese cost-benefit calculus and changeable political and economic configurations in the region. Still, I attempt to make some judgments based on the following three possibilities.

China's participation in the FTAAP

The most optimistic scenario is that China will consent to the idea of FTAAP and positively engage in the negotiations on agreement immediately after the process is launched. A possible motive behind this Chinese decision is to demonstrate that it is not a 'spoiler' preventing the agreement from going ahead, particularly when other APEC economies are likely to support the proposal. Moreover, whether China is interested in joining FTAAP crucially depends on how attractive an agreement could be concluded to address the issues central to China's interests, for instance, removing export restrictions, trade remedies and any discrimination against non-market economies. Only if these elements are embodied in the agreement, would the Chinese government be empowered to overcome severe political obstacles and convince domestic constituencies that concessions in the FTAAP are worthwhile.

Another less optimistic scenario could be that China may join at a later date on the voluntary basis, if a "pathfinder" initiative or "APEC-plus" approach is chosen to pursue the negotiation of FTAAP.

China's reaction if FTAAP fails

If the FTAAP unfortunately fails, whether due to the opposition of China or not, China would continue to pursue its building of an RTAs/FTAs network, while paying attention to the strengthening of the multilateral trading system and referring to "Best Practice of RTAs/FTAs in APEC". The APEC Best Practices based on consensus among APEC members provide a good reference for all members on how to conduct RTAs/FTAs on a voluntary

basis. On one hand, China would launch more RTAs/FTAs negotiations with other countries which it perceives as strategic partners, such as Brazil, Mexico, Singapore, and Russia. Particularly, it is highly likely that China will promote the establishment of EAFTA. On the other hand, China may also make its own contribution by seeking to create an “APEC template” for RTAs/FTAs that would set out a benchmark for individual agreements and negotiations.

The possible failure of FTAAP would also stimulate other APEC economies to continue the proliferation of RTAs/FTAs. In particular, as Bergsten (2005b) foresees, the U. S. is likely to initiate negotiations with Republic of Korea, Japan or some Southeast Asian countries (most likely Indonesia and/or Malaysia) for a bilateral free trade agreement. If these agreements are reached, China will become losers unless it initiates FTAs with those Asian countries. The U. S. would be specially annoyed by the proposal of EAFTA so that there must be some political and diplomatic actions to be taken in order to avoid “drawing a line down the middle of the Pacific”. All these outcomes will exacerbate the U. S.-China confrontation in APEC.

FTAAP launched without China’s participation

A number of proponents have suggested that the FTAAP negotiations could be a separate process independent of existing institutions which would maintain the APEC approach and organization. China would be under substantial pressures in the scenario that the FTAAP is launched outside APEC framework without Chinese approval, because of the possible significant trade diversion effects and discrimination against non-members. It is obviously not expected by the Chinese government. Therefore, such a “competitive liberalization” pressure, which was first raised by Bergsten, will induce China to seriously consider the possibility of joining the FTAAP at a later time, albeit its reluctance at the very beginning.

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ⁱ Calculated based on IMF, *Direction of Trade Statistics*, 2005, and UNCTAD, Comtrade Database (SITC Rev.3).

ⁱⁱ Calculated based on Chinese National Bureau, *Chinese Yearbook of Statistics*, 2005.

ⁱⁱⁱ A detailed description of “triangle trade” in the Asia Pacific please refers to UNCTAD, *Trade and Development Report*, 2005.

^{iv} Bergsten (2005b) points that “China’s soaring global current account surplus will probably approach \$150 billion and 7½ percent of its GDP this year, becoming the largest single counterpart to the US global current account deficit of about \$800 billion or almost 7 percent of its GDP. ”

^v According to WTO statistics, there were 2,743 anti-dumping measures reported during the period from 1995 to first half of 2005, of which 434 were against Chinese products, accounting for 16% (WTO, 2006).

^{vi} The data and other information in this section are quoted from WTO trade policy review reports submitted by the Chinese government (2006) and WTO Secretariat (2005).

^{vii} Calculated on the data of MOC, China.

^{viii} Hufbauer and Yee Wong (2005) illustrated several examples of Chinese enterprises’ activities in these industries.

^{ix} In 1996, President Jiang Zemin put forward for the first time the "APEC approach" guiding APEC cooperation. In the following years of summits, he repeatedly emphasized and elaborated on its nature and content from Chinese point of view, and ultimately forged a comprehensive and systematic deliberation of the approach which includes principles as follows: adherence to mutual respect, equality, mutual benefit; recognition of diversity; flexibility and pragmatism; gradual progress and openness; consensus; unilateralism and voluntarism. Detailed description of China’s contribution to APEC approach refers to Sheng Bin (2001).