

# FTAs and China

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## Abstract

In recent years, China has drawn a lot of attention, not only due to its rapid economic development and the WTO accession, but also due to its active attitude towards regional economic development. APEC is the first step for this initiative, followed by bilateral trade agreements or regional trade agreements with other economies, mostly neighbouring economies. As a developing country, China's experiences would provide some insights for free trade agreements among other developing economies.

This paper explores the present situation and motives behind China's FTA engagement and argues that an FTA provides China with some practical means to embrace the opportunities and face the challenges of being integrated into the world economy.

## 1. Introduction

Until the end of 2003, 194 Regional Trade Agreements (RTAs) had been notified to the World Trade Organization (WTO) (WTO, 2006). Especially in the latter half of the 1990s, the world witnessed a surge of RTAs. East Asia, as the most dynamic region in the world economy, still lags behind the rest of the world in terms of regionalism. But coming into the 2000s, many East Asian economies including China have been breaking with a strong history of multilateral activity, discussing and implementing regional preferential arrangements.

Beginning in the mid 1990s and accelerated by the Asian financial crisis, the FTA process in East Asia has been growing gradually but deeply. ASEAN was the first to launch the ASEAN economic community plan, with the aim of forming an integrated market and a productive base by the end of 2020 (ASEAN, 2004), though ASEAN free trade area has been operational with accelerated pace since 1992. Some

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East Asian economies, especially Singapore and Korea, have been actively involved in bilateral negotiations. Now China, Japan, Thailand, and Malaysia are also trying to keep abreast of the trend. Thailand has stepped out to establish separate negotiations with China. It has conducted a joint study with Korea into the feasibility of an FTA and has set up a joint task force to study how to promote closer economic relations with Japan. Malaysia, in a significant shift in policy, has started talks with Japan. East Asia has seen a web of FTAs emerging, which represents a new economic trend of economic integration and regionalism across Asia.

There are three types of FTAs in East Asia: a sub-regional grouping, like ASEAN or the conceived Northeast Asia FTA; bilateral agreements between two economies, like the Japan-Singapore Agreement for a New-Age Economic Partnership; the "ASEAN plus one" formula, like the just concluded China-ASEAN FTA (ACFTA), and the proposed Japan-ASEAN Comprehensive Economic Partnership which may include an FTA element. There are no FTAs existing in Northeast Asia.

Why are these East Asian economies so prone to form or join FTAs? Or in other words, why do they really want to form an FTA?

Firstly, an FTA is aimed at maintaining and expanding market access for East Asian economies' exports. At the beginning, for East Asian economies, forming FTAs was mostly a natural response to the slow progress on multilateral trade liberalization under the WTO as well as to the rising economic regionalism in the rest of the world. Faced with the difficulty in pursuing trade liberalization on a global scale, many countries in other parts of the world have opted to form FTAs with like-minded countries to pursue trade liberalization. As a result, in the 1990s, there were lots of FTAs emerging in the world, especially when Bush came into power. In fact, he has been firmly supporting the dual-track trade diplomacy, according to which the United States must prompt multilateral negotiations through the WTO framework, and, at the same time encourage bilateral negotiations under its Trade Promotion Act. Both the United States and Europe are major markets for the East Asian economies. By carrying out aggressive regionalism programmes, they have created considerable trade and investment diversion, which exerted a negative influence upon East Asian economies. For fear of a continual loss of export markets and foreign investment, East Asian economies tend to join in the FTA game in order not to be excluded from their former major trade partners' markets. They also take FTAs as a pre-emptive measure to form and keep a close economic relationship with potential trading partners.

Secondly, those bilateral or sub-regional FTAs are considered big steps, or building blocks towards institutional East Asian economic integration. In the late 1980s, East Asian intra-regional trade kept rising, and reached half of the total trade volume just before the Asian crisis. With the percentage well above that of NAFTA, East Asia has become the second largest regional grouping after the EU. Nowadays, with greater volumes of trade and investment occurring inside the region, the need for closer institutional cooperation involving all parties arises. This is due to the fact that the rising intra-regional trade is deepening the division of labour within the region, and will raise economic efficiency in the concerned parties. However, it will expose the economies to outside shocks. Thus, all parties attending regional division of labour need much more cooperation in many fields involving trade, financial, industrial policies and so on. In this sense, an FTA provides them a stable mechanism for consultation

as well as cooperation with each other.

Thirdly, it is hoped that an FTA could act as a self-help regional facilitator in times of economic hardship. During the 1997 financial crisis, neither the IMF, nor the APEC came to the affected economies with helping hands. As the crisis broke out, it was Japan that first stepped up the bilateral cooperation with the crisis-hit economies through the New Miyazawa Initiative. As part of this Initiative, Japan entered into currency swap arrangements with Malaysia and the ROK, which guaranteed the provision of foreign currency reserves in case of a crisis. Since then, more and more regional countries have shared the common desire to develop a regional financial mechanism for resource provision, eventually leading to the adoption of the Chiang Mai Initiative (CMI) by the ASEAN plus Three Finance Ministers in May 2000. The crisis uncovered deep problems in East Asia. An FTA would give new stimulus to the future development by means of market expansion and economic cooperation.

Fourthly, expanded intra-regional trade through FTAs among East Asian economies will reduce their export reliance on American markets, consequently decreasing their capital outflow to the US, so as to increase the so-badly-needed investment within the region and help promote long-term development. With a low saving rate and a strong inclination to consumption, the US has the highest current account deficit and budget deficit in the world. Since the US is one of the most important markets for East Asian exports, in order to support American continuous purchases of their export product, East Asian economies have to lend them money at a lower interest rate than in their internal markets. That is to say, Americans are using cheap money from East Asia to buy East Asian cheap products; they are enjoying the benefits of globalization to a full extent. What East Asian economies mostly get is only a relatively higher employment rate. Under regional FTAs, if East Asian economies could enlarge their intra-regional trade and facilitate capital flow within the region, not only could a higher employment rate be maintained, but also a higher return of capital would be achieved with much more investments towards the region.

Fifthly, it should also be noted that an FTA is taken by its East Asian participants as a WTO-plus mechanism to deal with the newly emerging international economic activities such as FDI, trade in services, labour mobility, and others that the GATT/WTO rules have not yet approached. To put it differently, the rules concerning border measures such as tariffs, which are the main focus of the GATT/WTO, cannot provide foreign as well as domestic companies with the level-playing field. It is necessary to go deeper beyond these border measures and to set up the rules covering domestic systems such as competition policy. Many countries share a view that GATT/WTO cannot provide such rules and opt for FTAs to deal with the problem (Urata, 2004).

This article is organized as follows: the first part is the introduction which gives a broad background of the recent emergence of FTAs in East Asia. The second part is China's FTAs including those signed and under discussion. The third part makes a detailed analysis of the motives behind China's commitment, and the last part is the conclusion, which is, in fact, some implications of China's experience.

## 2. China's FTA Commitments

Nowadays, China's FTA strategy shows a clear roadmap: sub-regional FTA arrangements plus bilateral FTA arrangements (Xu Mingqi, 2003). Now China has two "Closer Economic Partnership Arrangements" (CEPA) respectively with Hong Kong and Macao, and has just concluded negotiations of the China-ASEAN FTA (CAFTA). In order to promote an East Asian FTA as early as possible, China even proposed an early settlement on a trilateral FTA in the Northeast Asian region, although it would be the weakest among the three countries. However, the proposal was declined by Japan, and the China-Korea FTA is still under academic discussion. Moreover, China is also seeking the possibility of establishing bilateral FTAs with Singapore, Thailand, the Philippines, Australia, and New Zealand.

## 2.1. China-ASEAN FTA (CAFTA)

Bilateral trade between ASEAN and China has quadrupled in the past decade, growing by an average of 15 per cent annually since 1995 despite the adverse impact of the 1997 Asian financial crisis. Currently, ASEAN is China's 5th largest trade partner, and China is ASEAN's 6th largest partner in terms of trade volume. For many years, since the early 1990s, China has had a trade deficit with ASEAN.

Table 1: 2001-2005 China-ASEAN Trade

	2001	2002	2003	2004	2005
Total trade with ASEAN (million USD)	4,1614	54,765	78,252	105,879	130,370
% variation over the same period of the previous year	5.3	31.7	42.8	35.3	23.1
Percentage of total trade volume	8.2	8.8	9.2	9.17	9.17
Exports to ASEAN(million USD)	18,385	23,568	30,925	42,902	55,371
% variation over the same period of the previous year	6.0	28.3	29.4	38.7	29.1
Percentage share in total exports	6.9	7.2	7.1	7.23	7.27
Imports from ASEAN (million USD)	23,229	31,197	47,327	62,978	74,999
% variation over the same period of the previous year	4.7	24.4	51.7	33.1	19.1

Percentage share of total imports	9.5	10.6	11.5	11.22	11.36
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Source: MOFCOM ( <http://www.mofcom.gov.cn>).

In order to promote future economic cooperation, in 2001, Chinese Prime Minister Zhu Rongji came up with a proposal for an ASEAN-China Free Trade Agreement. Both sides signed the Framework Agreement on China-ASEAN Comprehensive Economic Cooperation (FACACEC) in Cambodia, in 2002, which laid the foundations to negotiate a China-ASEAN Free Trade Agreement. According to FACACEC, China-ASEAN has two time schedules: for China and ASEAN's old members<sup>2</sup>, the deadline for zero tariff and elimination of non-tariff measures is 2010; for ASEAN new members<sup>3</sup>, the deadline is 2015<sup>4</sup>.

The formal negotiations on the China-ASEAN Free Trade Area, or FTA, began in early 2003 and were supposed to conclude by June 2004. However, the deadline has not been met. At the Eighth Summit in Nov. 2004 in Laos, China and ASEAN signed the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, and the Agreement on the Dispute Settlement Mechanism between China and ASEAN. These documents mark the birth of the process of the China-ASEAN FTA. Other important negotiations, such as investment and trade in services, have not been finished yet.

According to the Agreement on trade in goods, China and ASEAN will eliminate all the tariffs and non-tariff barriers step by step<sup>5</sup>; excluding the exceptional products allowed by the WTO, very few sensitive products; stipulating ROO; and other rules (subsidies and countervailing measures, anti-dumping and safeguard measures; and a dispute settlement mechanism).

For ASEAN 6 and China, each party shall eliminate all its tariffs for tariff lines placed in the Normal Track not later than 1 January 2012; while for other new members of ASEAN, each party shall eliminate all its tariffs for tariff lines placed in the Normal Track not later than 1 January 2018. As for sensitive products, ASEAN 6 and China can put forward 400 tariff lines at the HS 6-digit level and 10% of the total import value, based on 2001 trade statistics; and other new members have more favourable treatments.

Actually, during the discussion of CAFTA, China and ASEAN decided to implement an Early Harvest Programme, in which the list of products and services will be determined by mutual consultation, before agreements on trade in goods, investment and services have been reached formally. The Early Harvest Programme includes most products in the chapters, such as Live Animals, Meat and Edible Meat Offal, Fish, Dairy Produce, Other Animal Products, Live Trees, Edible Vegetables, Edible Fruits and Nuts.

<sup>2</sup> Brunei, Indonesia, the Philippines, Malaysia, Singapore and Thailand (ASEAN-6).

<sup>3</sup> Vietnam, Laos, Myanmar, and Cambodia

<sup>4</sup> Although ASEAN has been negotiating with China as a group, in order to enjoy benefits of the trade liberalization ahead of schedule, its individual members could reach agreements with China under the frame of the "Early Harvest" programme, for example, the agreement concluded by China and Thailand, according to which both of them agreed to eliminate the tariff on fruits and vegetables mutually since Oct. 1, 2003.

<sup>5</sup> The first tariff reduction of CAFTA begins in agricultural goods, which makes CAFTA different from most of the FTAs in the world.

In terms of services and investment, negotiations are under way. However, according to the framework agreement between China and ASEAN, in trade in services, both parties committed to eliminate all the discrimination and forbidding measures and gradually achieve service trade liberalization in numerous sectors. As for investment, both parties promised to liberalize investment regimes, and provide investment protection. In order to promote economic cooperation, China and ASEAN firstly identified five priority areas, including agriculture, information technology and communications, human resource development, investment, and Mekong River basin development; secondly, they put emphasis on concrete cooperation such as trade facilitation, enhancement of competitiveness of small and medium enterprises; e-commerce promotion, capacity building, and technology transfer.

However, CAFTA has some inherent shortcomings which could hold back the process towards a successful FTA. Firstly, ASEAN consists of ten members, whose trade policies are very different. For example, Singapore and Thailand are more open in terms of trade policy; Malaysia takes import-substitution and anti-dumping policies; Laos, Myanmar and Cambodia are still restricted by the traditional non-market systems and cannot bear the impact of trade liberalization. Secondly, ASEAN did not integrate itself deeply enough so that members cannot have a common policy to the outside world. This makes the negotiation more difficult, because any agreement needs China to negotiate with each ASEAN member respectively. If China's negotiation with any ASEAN member fails, the whole process will be lagged. To date, China and ASEAN members have not included those sensitive products in their negotiations (like rice, rubber, cars and industrial products), so the process seems very easy. But when the process deepens, both China and ASEAN will have to reduce their sensitive product list, which will be a real test for CAFTA.

Despite the difficulties existing in the process of CAFTA formation, China and ASEAN leaders have every confidence in it, because there are some factors which make our optimism reasonable: the Chinese government has more strategic considerations than economic ones; ASEAN is longing to ride China's economic express train; the number of sensitive products is limited; bilateral trade is not so much that would pose threats to both parties, etc. As a result, we are convinced that the goal for 2010 will be achieved, though the process might not be so smooth.

## **2.2. Closer Economic Partnership Arrangement (CEPA)**

The Hong Kong Special Administrative Region (SAR) government and the Chinese central government signed the Closer Economic Partnership Arrangement (CEPA) on June 29, 2003, which came into effect on January 1, 2004. According to CEPA, the mainland has not only opened its goods market, but also opened its service sector to Hong Kong, which is the SAR's best advantage, accounting for 85% of its GDP. Hong Kong is very eager to fully participate in the Mainland's huge emerging service market.

The opening process was designed step by step. The first phase of CEPA started on January 1, 2004. In this phase, Beijing had agreed to eliminate tariffs on 374 Hong Kong goods starting in January and to

open 18 service sectors to Hong Kong companies. The second phase began on January 1, 2005, and it was based on the CEPA supplementary agreements signed by both parties in October, 2004. According to the new agreements, more products made in Hong Kong have been enjoying a duty-free policy. China has extended the preferential tariff policy to other 339 items of Hong Kong goods—more than a 90% increase—which include aquatic products, food, chemicals, textiles, electromechanical products, among others. Then, nearly all goods produced in Hong Kong will enjoy zero tariffs. So the total variety of duty-free goods has expanded from 374 to 713; meanwhile, the Mainland will further open up eight more industries to Hong Kong companies.

Investment facilitation is another major content of CEPA between the Mainland and Hong Kong. At present, 2,000-plus Mainland China-investment companies do business in Hong Kong and they own total assets at USD 220 billion. The Hong Kong Special Administrative Region was eager to make related departments of Mainland simplify investment approving procedures for domestic enterprises so as to facilitate investment by Mainland companies in Hong Kong. Such proposals are still under discussion. In fact, CEPA is an open-end agreement, which means that, if needed, any new measure could be added. In 2005, the governments at both sides were going to prepare for the implementation of the third phase of CEPA, which was scheduled to start in 2006.

Since CEPA came into effect in 2004, Hong Kong's duty-free exports to the mainland hit USD 127 million; the total of tariffs waived under CEPA reached 66.43 million yuan (USD 8.08 million). More importantly, its manufacturers feel more confident than before and begin to raise their capital investment. In the first three quarters of 2004, purchases of manufacturing equipment, especially for the textile and garment sector, increased by 33 per cent year-on-year. Moreover, since the agreement has greatly strengthened Hong Kong's role as a bridge linking the mainland with the rest of the world, Hong Kong has been attracting a lot of attention from foreign investors, who are more likely to take Hong Kong as a stepping stone to the mainland market. Therefore the existence of CEPA will be conducive to maintaining Hong Kong's position as an important service as well as a financial centre of East Asia.

In December 2003, China signed a CEPA with Macao with almost the same contents. From January 1, 2004, not only 272 categories of logistics from Macao have been enjoying zero tariff to access the Chinese mainland, but the bilateral trade and cooperation on industrial projects was also facilitated; Macao's exports to the mainland under CEPA were at USD 232.200 in 2003, and the tariffs reduced in line with CEPA were 122.000 yuan (USD 14.842).

### **2.3. Other Bilateral FTAs signed or under discussion**

China is actively pushing for progress in FTA talks in Asia and outside the region.

a) The second FTA China signed was with Chile. China is Chile's fifth largest trading partner, and Chile is China's third largest trading country in Latin America. During the first 5 months of 2006, the two-way

trade reached USD 2.94 billion, representing an increase of 8.1 per cent on a yearly basis. Ninety per cent of exports from Chile are copper and other ores. It is believed that China will soon surpass Japan to become Chile's second largest export destination, after the United States.

In 2003, China and Chile launched FTA negotiations, and in October 2004, they concluded a feasibility study on said FTA. Chile has granted China market economy status (MES) in anti-dumping and anti-subsidy cases so as to clear the last obstacle in their way to their FTA negotiation. Negotiations started in January 2005, and finished in November 2005. The China-Chile FTA is the first China's FTA with a Latin American country. Both parties would start their tariff reduction on goods by late 2006. Tariffs on 7,336 products which account for 97.2% of China's whole tariff lines and 7750 products which account for 98.1% of Chile's whole tariff lines will be eliminated by stages in 10 years, among which are zero-tariff products implemented immediately after the agreement was signed that include chemicals, textiles and garments, agricultural products, machinery and electrical products, and transportation products. It is estimated that with the FTA in place, two-way trade volume will easily exceed USD 10 billion by 2008.

b) After the negotiations on the China-ASEAN FTA were concluded in 2004, an FTA with a single ASEAN member could possibly be sped up. Some more developed ASEAN countries, including Singapore, Malaysia and Thailand, which have granted market economy status to China, are requesting signing agreements with China as early as possible. Singapore is the most active one among them, for China is now Singapore's second-largest trading partner, with trade at nearly USD 40 billion in 2004, while Singapore is China's seventh largest investor. As of 2003, China has attracted a combined investment of USD 24.3 billion from Singapore. Through a more special and concrete bilateral FTA framework, Singapore wishes to get more access to China's growing service market and further facilitate its investment.

c) The GCC (Gulf Cooperation Council) is a regional economic organization established in 1981 which comprises the six Gulf States: the United Arab Emirates, Bahrain, Kuwait, Oman, Qatar and Saudi Arabia. With China's rising imports of oil from the Gulf countries and exports of its manufactured goods to the region, trade volumes grew rapidly between China and the GCC. Sino-GCC trade volume jumped to USD 17 billion in 2003, an increase of 46 per cent year-on-year. China is now the GCC's third largest trading partner, behind the United States and Japan. The GCC countries have now become China's eighth largest trading partner. Bilateral cooperation in the field of energy, in particular, should be a brighter prospect, given that the GCC states control 45 per cent of the world's oil reserves and China serves as one of the world's largest oil-consuming countries.

In July 2004, China and the Gulf Cooperation Council (GCC) signed the Framework Agreement on Economic, Trade, Investment and Technological Cooperation in Beijing. The two parties launched FTA talks in September 2004. According to officials from both sides, the proposed China-GCC FTA would include tariff reductions, simplification of trade flows and facilitation of mutual investments. The proposed programmes include sustainable oil supplies from the GCC to China, China opening its oil product market to GCC countries, and joint exploitation of their oil resources.

d) Australia is abundant in iron ore, natural gas, unwrought aluminum, copper, and is one of the biggest producers of wool and wheat. Meanwhile, with China's economy developing rapidly, its demand for raw



materials is expected to grow. In addition, Australia's education and tourism are attracting more and more Chinese people, while China's inexpensive consumer goods including computers, clothing, video and digital cameras, mobile phones and sporting goods are becoming popular in the Australian market. So it is sure that both countries are complementary in their economies, and have vast opportunities for economic cooperation. Now China is Australia's third-largest trading partner. Australia is China's ninth-largest trading partner.

In 2004, a trade and economic cooperation framework was signed by both countries. A feasibility study on the Sino-Australian free trade agreement (FTA) was concluded in the first half of 2005, well ahead of the previous deadline. It was revealed in this study that a China-Australian FTA would bring USD 18.2 billion to Australia and USD 64 billion to China in ten years' time. In April 2005, Australia gave full recognition to China's market economy status (MES), which facilitated the elimination of one of the core problems in bilateral negotiations. At the same time, the bilateral FTA negotiation was initiated as well. On China's part, there is concern regarding the fact that agricultural and service sectors are very vulnerable, being less developed than those in Australia; while in Australia, they are trying to persuade China to reduce by up to 15 percentage points tariffs on beef, mutton and dairy products. Hence, in these sectors, agreements could be hard to reach.

e) New Zealand and China reached a trade and economic cooperation framework agreement in May 2004. According to the feasibility study that was concluded late that year, the economies of the two countries are strongly complementary. Most exports from China to New Zealand include: electrical and machinery products (accounting for about 1/3), apparels, high-tech products, textiles, shoes, plastic products, and toys; while imports include wood, wool, paper and paper pulp, iron ores, etc. Bilateral formal negotiations started in December 2004. The negotiation is expected to be finished in 1-2 years.

f) China and South Africa launched Free Trade Agreement (FTA) negotiations after the latter recognized China's market economy status in 2004. South Africa is now China's largest trading partner in the African continent. Bilateral trade increased from USD 1.47 billion in 1990 to more than USD 3.7 billion in 2005. As one of the most important key partners in Africa, China is willing to forge a strategic partnership with South Africa to seek equal and mutual benefits and common development.

g) Besides the above, in April 2005, China also announced it would prepare FTAs with India and Pakistan. With regard to China and India, their total population reaches 2.3 billion. In 2004, bilateral trade amounted to USD 13.6 billion, and bilateral investment was less than USD 0.3 billion. China is India's second trade partner just behind the US. India exports raw materials such as iron ores and software services, while China exports electric consumer products and telecommunication products, which means they complement each other. Both countries have great demands for energy and raw materials, which have aroused the wish for both to cooperate in the international energy market in the near future. Hence, with a view to large economies of scale and great complementarities, China and India decided to begin the FTA feasibility study in April 2005, though both parties have given each other preferential treatments in tariffs under the Bangkok Agreement. It is hoped that a China-India FTA helps promote bilateral trade above USD 20 billion in 2008.

h) Pakistan is the second largest South Asian country which China is considering undersigning an FTA with. Currently, 70 per cent of Pakistani exports to China are cotton yarn and cotton fabric. The rest are leather products, minerals and seafood. China's main shipments to Pakistan include machinery equipment, chemicals, electronics and footwear. A protocol was signed related to the talks on the establishment of an FTA between the two nations whose current annual trade volume is at USD 2.5 billion. Negotiations started in January 2005 and the EHP (Early Harvest Programme) was already signed in April of the same year. The Early Harvest Programme mainly focuses on agricultural products. The farm products Pakistan possibly benefits from through this programme include rice, mangoes, potatoes, onions, dates and apricots. For China, a Pakistani market with 150 million people is undoubtedly a source of great opportunities. A Sino-Pakistani FTA, which would mean lower or zero tariffs for many products, could make the market more attractive. Some Chinese pesticide producers have already seen a great market for Chinese pesticide and fertilizer producers and are thinking of investing in Pakistan because of the market demand and the low labour costs.

### 3. Motivations behind China's FTA Engagements

In the early 1990s, China was not very enthusiastic about regional trade commitments of a more formal or structured nature, partly because it was not yet ready for rapid trade and investment liberalization at home. The strong objection of the United States to the formation of any East Asian economic grouping (such as the East Asia Economic Caucus proposed by Malaysia) also revealed the political implications of any attempt to take new regional economic initiatives. China's participation in the Asia-Pacific Economic Cooperation (APEC) was cautious as it insisted that APEC should remain a "forum."

However, at the break of the 21st century, China's attitude towards regional cooperation changed significantly (Wang Jisi, 2004). Firstly, the WTO accession, on the one hand, forced China to make many commitments in terms of market liberalization; and on the other hand, it integrated China deeply into the world economy. For example, in terms of trade-to-GDP-ratio—one simple indicator of openness—China has already become an open economy. The ratio is currently over 60 per cent, compared to the scant 20 per cent in Japan. Likewise, in recent years foreign direct investment in the PRC economy has equaled about 18 per cent of total investment, which compares to a 6 per cent level in the United States. This necessitates institutional arrangements which could further reduce trading costs while keeping and promoting the increasing trend of trade and investment increase.

Secondly, since China's rapid emergence has raised concerns in neighbouring countries, China has to prove itself a responsible and positive factor in keeping prosperity and stability in the whole region. China's transition toward modernization needs a peaceful environment, which is an important objective of its diplomacy. China hopes that, through regional cooperation, it will be able to build an amicable, tranquil and prosperous neighborhood. Signing FTAs with regional economies will help to ease their doubts and distrust. Thus, China's FTA policy constitutes an integral part of its friendly-neighbour diplomacy. The China-ASEAN FTA is a typical example of this.

ASEAN is China's closest neighbour. That ASEAN keeps its stability and maintains a cooperative relationship with China will well serve China's interest. Therefore, China always attaches great importance to developing its relationship with ASEAN. Before the Asian crisis, ASEAN members maintained a high GDP growth rate: 6.8 per cent annually in the 1990 to 1997 period. However, the financial crisis that broke out in 1997 suddenly brought the growth of exports, as well as that of the regional economy as a whole, to a halt. During those hard times, China tried its best to keep the currency exchange rate stable; by doing so, China stopped the second wave of competitive devaluation of the local currencies, which might have damaged the regional economy further and delayed the recovery in the future. Moreover, the fast growing Chinese market also provides many opportunities for ASEAN's exports. As a result, ASEAN members may have mixed feelings toward China: on the one hand, with China's imports from ASEAN increasing, ASEAN members rely more on China's economic performance than before; on the other hand, they might feel fiercer competition from China's products in the third market, and see more FDI flow to China than to their markets. For this reason, China may seem to them more like a challenge than an opportunity. The China-ASEAN FTA proposal by China has helped make things different, since through CAFTA, ASEAN will get enhanced access to China's huge market than China's non-member trading partners and, hopefully, its attractiveness for FDI may also be recovered. In order to show its sincerity to ASEAN, China even included the agricultural sector in the negotiations, under the "Early Harvest" package, making a striking contrast with Japan.

Thirdly, the promotion of regional economic development in China is another reason for the signing of an FTA, which could be seen from two perspectives. In the case of Hong Kong and Macao, as another important Chinese regional initiative, the Closer Economic Partnership Arrangements (CEPA) are aimed at deepening integration of their economies into the Southern part of the Chinese economy, which serves as an effective instrument for promoting economic development and political stability in these two Special Administrative Regions of China.

Hong Kong and Macao are two Special Administrative Regions (SAR) of China, where the "one country, two systems" policy is practiced. Under the "two system", their products cannot freely enter the Mainland market, and their companies operating in the Mainland are treated as foreign-invested enterprises. With China's accession to the WTO, China is increasingly integrated into the world economy. These two SARs are in urgent need of strengthening their economic ties with the Mainland so as to get better access to China—ahead of the general opening to China's other trading partners. Especially in Hong Kong—seriously affected by the 1997 crisis, after which it experienced the worst recession as deflation set in—wages were frozen, and unemployment hit a high of 8.9 per cent over the following years. In order to restore the business confidence in Hong Kong and also increase Hong Kong's attractiveness to foreign investors, China's central government agreed to form a CEPA with Hong Kong. Under the CEPA framework, Hong Kong will establish a closer economic partnership with the Mainland compared to their WTO links so that it can make the most of the Mainland's fast growing economy and get itself a new standing in the world economic map.

In other cases, such as ASEAN, South Asian and Northeast Asian economies, China aims to accelerate economic development in some specific regions as well, most of which are located in the west or the northeast, and lagging greatly behind other regions in this country. For instance, CAFTA is expected to provide more opportunities for southwestern provinces such as Yunnan, Guangxi, and even other middle-west cities and provinces such as Chongqing, Sichuan, etc. These provinces have been

suffering from a lack of “a window to the sea”; while CAFTA would not only be able to provide this window, but also create a larger market for those inland enterprises to export TV sets, audios and videos, motorcycles, and other products with middle-level technology. An FTA with northeast Asian countries such as Japan and Korea could benefit older industrial areas in the northeast part of China, which includes Heilongjiang, Jilin and Liaoning provinces. These areas have even played a critical role in the early stage of China's industrial development, but lagged greatly behind since China adopted openness and an export-oriented policy. An FTA is expected to facilitate their trade with Japan and Korea, and particularly their absorption of more direct investment and technology from these two countries.

Fourthly, China's FTA policy helps it gain easier access to the world market. Although China accessed the WTO in December 2001, the stagnation of WTO negotiations and the expansion of regionalism in the rest of the world made China aware of the importance of regional trade agreements as a necessary alternative to the multilateral trading system in pursuit of a more liberalized trading environment. On the one hand, an FTA is an efficient device to ward off future protectionist pressures from its trading partners and manage trade tensions with them in an orderly manner.

Due to China's non-market economy status labeled by most WTO members, China has faced an increasing number of anti-dumping law cases. Because market economy status will establish common principles and standards to negotiate the rules that govern trade among trading partners, attaining market economy status is vital to the fair treatment of Chinese products. China adopted a pragmatic measure—an FTA—in which it focuses on breaking through in certain countries and solving the problems one by one. Australia is a member of the OECD and it has signed free trade agreements with New Zealand, Singapore and Thailand, and is conducting an FTA negotiation with the United States. Therefore, China attaches great importance to the cooperation with Australia, for Australia's decision will influence many others. Up to now, New Zealand, all ASEAN countries, Argentina, Australia, Chile, Peru, Pakistan and South Africa have granted market economy status to China, and most of them are looking forward to signing or have already signed an FTA agreement with China. Apart from the market status, an FTA is also a reasonable response to some protection measures specific to China. For instance, the EU has given some least developed economies in Asia—but not China—favoured treatment in terms of textile and ordinary machinery on many occasions. However, if China invested in these economies, the barriers would be got round to the most extent.

On the other hand, through their grouping with other countries, an FTA would increase its participants' bargaining position in relation to the existing or emerging blocs in the rest of the world. In the case of India, two large developing countries in the world have now agreed to cooperate with it in an FTA, which matters in a symbolic sense as well as in an economic sense. In the WTO, the BRICs (Brazil, Russia, India and China) have already begun to voice their opinions as a group. Bilateral free trade agreements provide an alternative for them to find more mutual benefits, reduce destructive competition and coordinate positions. The forthcoming cooperation in the energy field between China and India is expected to see a good beginning, which could raise their bargaining power. Some experts have suggested that China and India should make agreements to prevent intense competition against each other and to develop an energy and technology project for environment protection with a win-win

prospect.

Fifthly, with rising international prices of oil and iron minerals, China's FTA policy is paying more attention to energy security as well as to gaining stable supplies of raw materials at competitive costs so as to sustain its economic development. The former can be clearly seen in its cooperation with GCC. With its rapid economic growth, China has developed a growing appetite for energy, especially oil. The demand has far outpaced domestic supplies. For securing a necessary energy provision, China has been talking with a number of global oil suppliers to diversify its oil sources to feed a booming economy. But the Middle East and Gulf regions have an irreplaceable strategic position due to their high oil quality, easy transportation, and low oil exploitation costs. Meanwhile, the war in Iraq and the rising dominance of the United States in the Gulf region push the GCC to seek FTAs with other countries, including the European Union (EU), Japan and China. In order to introduce new players to balance the United States in oil exploitation and diversify their oil export, they have begun to open their relatively closed and monopolized oil prospecting and exploitation market to Russian, French and Chinese companies in recent years. Thus, China and GCC are getting closer. In fact, since ASEAN holds a strategic location in China's energy navigation route, that is also an important reason for China to pursue a close cooperative relationship with ASEAN.

Besides, with China being the manufacturing centre of the world, its demand for various industrial raw materials also maintains a high growth rate. To keep up with its rising demand, China not only needs to expand its overseas supplies as a whole, but also to establish its own stable supply bases. Both Chile and Australia have a common feature: both of them are rich in mineral products. Chile is the world's largest copper supplier, while China is the largest copper consumer in the world. Nowadays copper accounts for 62 per cent to 68 per cent of Chilean exports to China. Both of them have already strengthened their cooperation with copper mining. Although Australia is a developed economy, it is one of the largest exporters of primary goods in the world. Among its exports to China in 2003, mineral products accounted for 42% of the total imports from Australia, and non-edible raw material for 56%. China also increases its imports of mineral products from South Africa. The case is the same for ASEAN. Apart from its primary *commodities*, ASEAN's resource-based products are also in great demand in China. It is obvious that establishing an FTA with these countries will be conducive for China to meet such objective.

## 4. Conclusions

Firstly, China is a normal country. It does her best to serve and secure its national interests. Because of this, China will take a pragmatic position and attitude towards cooperation with other countries, in the role it can play in international organizations in particular, and in the world economic and political system in general. In our opinion, this is the main philosophy on which China's international and diplomatic policies are based.

Secondly, as far as China's FTA strategy is concerned, the main motivation for China is defensive. After the WTO accession, China's trade more than doubled by 2005. The rapid expansion of international trade triggered trade disputes with other countries. Nowadays, one of every 6 antidumping cases in the world is against China. And only after the WTO accession was China fully aware of the unfavourable impacts of those discriminatory articles in the Packages of WTO commitments such as non-market economy status (2016); Transitional product-specific safeguard mechanism (2013); and Textile-specific safeguard mechanism (by the end of 2008). Formulating an FTA with other members is one of the most urgent and important objectives in order to remove those discriminations against China.

China started FTA negotiations formally with other economies only after 2001, that is, only after its WTO accession. China got more legacies from its 15 year' WTO accession process. For example, 1) the discriminatory articles of WTO commitments force China to formulate FTAs with other members in order to get some relief from being subject to those articles. 2) China gradually got aware of its economic potentials and bargaining power in reciprocal negotiations. China also became aware of its impacts on other countries in terms of challenges and opportunities. An FTA with other members can take advantage of her bargaining power. 3) A group of experts and officials was formed as a result of the WTO negotiations process. Formulating an FTA provides a fresh opportunity for those assets.

Thirdly, an FTA could be a possible choice for some issues faced by China. China used to be an international price-taker in the world market and a rule-taker in the world economy. China has always been concerned about issues such as how to integrate into the world economy, how to respond to the changes in the world economy and so on. Rarely has it been concerned about the impacts of its economic policies on the world economy. The situation has been changing in the last 10 years. The echoes of the threats of China's rising are heard in other countries once and again, though these countries have benefited greatly from China's growth. The international impacts of domestic policies are now important variables in the policy formulation process in China.

Apart from China's threat, the trade imbalance with other countries has also drawn much attention. In the last 20 years China has successfully integrated into the East Asian economy in particular and into the world economy in general. Currently, China has become a bridge between Japan and Asian NIEs on the one hand, and the US and the EU on the other. Each year, China earns trade surplus from the US and the EU, and then transfers most of it to the other side, because China has a huge trade deficit with Japan and Asian NIEs. Take 2005 for instance. China obtained USD 300 billion trade surplus from the top-10 trade surplus sources, and USD 150 billion trade deficit from the top trade deficit sources of China. On balance, China's trade surplus is USD 100 billion. So, the trade imbalance between China and the US is not a bilateral issue any more, but a regional or global one. The solution is not to be found on a bilateral level only, but also on a regional and even multilateral one.

China also does its best to cooperate with other countries in order to find creative solutions to its development. An FTA is a good choice.

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