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# China's New Regional Trade Agreements

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## **Abstract**

This paper discusses the recent regional trade agreements that China has concluded rapidly following accession to the WTO in 2002. Agreements are in place with Hong Kong, Macao, ASEAN, Australia, and New Zealand, and are either in negotiation or under discussion with South Africa, Chile, India, and the Gulf Cooperation Council. These agreements differ sharply in form and substance, and involve process commitments to ongoing negotiation and cooperation on a wide range of issues. Differences relating to the regional agreements negotiated by the EU and the US are emphasized, as are later potential difficulties these agreements create in moving to an Asian trade bloc centred on them.

## 1. Introduction

Most of the recent discussion of Chinese trade policy from outside China has been of China's WTO accession, assessing both the commitments themselves and the process of implementation (Bhattacharjee, Li, and Martin (2004), Whalley (2003)). Less attention has been given to the network of post WTO accession regional trade agreements that China is now in the process of negotiating. Agreements, or initial frameworks of agreements are now in place with Hong Kong, Macao, ASEAN, Australia, and New Zealand. Discussions on possible FTAs with India, Chile, Singapore, South Africa, the Gulf Cooperation Council are underway. Possible direct or indirect arrangements involving Korea and Japan are the subject of speculation. Thus, what we may be witnessing with China's new regional trade agreements is the emergence of a third wave of large power regional agreements which will likely set the precedent for other Chinese regional agreements to follow in future years.

China, like other large powers in the trading system (the US and the EU) has clear incentive to commit to multilateral disciplines in the WTO as a way of gaining non discriminatory access to large markets and head off discrimination against her either in both these or smaller third country markets by fellow large powers. But closer to home (and as with the US and the EU) China has equally clear incentive to negotiate supplemental regional arrangements which deal with interests in local markets in ways which go beyond WTO disciplines. The US with NAFTA, and the EU with accession and other agreements have encountered similar incentives with similar results.

But there are several striking features of China's emerging network of agreements which differentiate it both from the one off negotiation of NAFTA by the US in 1991 and the process of ever deeper EU integration initiated by the 1957 Treaty of Rome. The first is the diversity of these agreements, both in form and coverage. For example, the agreement with Hong Kong is concrete and focused on both goods trade and cross border investment and financial activities, while the agreements with Australia and New Zealand are largely general indicative statements of intent in much wider number of areas. Diversity of approach while it seems to be the hallmark potentially makes the later emergence of an Asian trade bloc centred on these agreements more problematical.

A second feature is their seeming brevity, and hence the inevitably vagueness of the texts involved (the Hong Kong and Macao Closer Economic Partnership Agreements (CEPA) have only thirteen pages of main text with additional annexes). Much seems to be left to subsequent joint agreement and mutual management of the trade relationship. A third feature is the absence (unlike especially the US agreements) of explicit and clear dispute resolution procedures with conciliation between the parties being relied upon. Other features are extensive lists of specific bilateral commitments in services (especially in the case of CEPA) which go beyond the form and type of commitments undertaken by most WTO members in the GATS. Another is extensive attention devoted to arrangements both for joint ventures and the operation of financial institutions in a joint regulatory environment in the Hong Kong Arrangement.

The focus of recent US bilateral initiatives seemingly on gaining unilateral access for key service sectors in partner countries in return for accelerated bilateral tariff elimination (see Schott (2004)), and of recent EU bilaterals on wider diplomatic linkage to trade and competition policy (see Brenton (2002)) find no parallels in these emerging Chinese agreements. Instead, the

emphasis for now is primarily on trade access for manufactures through bilateral tariff reduction/elimination and bilaterally scheduled commitments in services.

The majority of literature on regional trade agreements from economists continues to treat them all as relatively similar in structure, despite the fact that the reality is quite different. Here a third set of agreements, further differentiated from the already different US and EU regional agreements, seem to characterize early Chinese regional negotiation, and more agreements seem likely to follow. We first discuss the Hong Kong CEPA agreement, next the China-ASEAN agreement, and the Australia, New Zealand agreements, and then what seems to be emerging on other fronts. We conclude with a discussion of what the Chinese interest may be in further elaborating this network of treaty arrangements in the future.

## **2. The Closer Economic Partnership Arrangements with Hong Kong and Macao**

China's Closer Economic Partnership Arrangement (CEPA) with Hong Kong was signed on June 29<sup>th</sup>, 2003 with the stated broad aims of promoting joint economic prosperity and development, and facilitating the further development of economic links between China, Hong Kong, and other countries (regions)<sup>1</sup>. It contains 13 pages of text and 6 annexes. Its main content lies in progressive bilateral reduction or elimination of tariff and non-tariff barriers applying to goods trade, reducing bilateral restrictions on service trade, and various steps to further promote bilateral trade and investment. As a formal free trade agreement, the Hong Kong CEPA was notified to WTO on January 12, 2004<sup>2</sup>. So far a working party has not been established and factual examination by the WTO Committee on Regional Trade Agreements has not started yet.

Under the agreement Hong Kong maintains its current zero-tariff policy towards goods imported from the Mainland, with a staged tariff elimination for goods imported by China from Hong Kong. China agrees to introduce zero tariffs for a list of goods specified in Annex 1 as of January 1, 2004<sup>3</sup>. Full elimination of bilateral tariffs will occur no later than January 1<sup>st</sup>, 2006. All goods have to meet CEPA rules of origin (details on these rules are in Annex 2). Imports claiming origin must also be accompanied by a valid Certificate of Origin. To acquire Hong Kong origin a good must have 30% value added in Hong Kong (this includes the value of raw materials, labour costs, component parts, and product development costs). Foreign companies in Hong Kong can export goods to China under CEPA if the products meet the added value requirement.

The Macao Closer Economic Partnership Arrangement is almost identical to the Hong Kong CEPA. The minor differences come from slightly different names of agencies and regulations in Hong Kong and Macao, and the lists of goods in Tables in Annexes 1 & 2 differ in some areas. Everything else is the same including the main text, Rules of Origin, and other requirements for entities operating in the Mainland. The date of signing the documents was October 17, 2003 and the Macao CEPA has also been notified to WTO (in March 2004).

For non-tariff measures on goods these agreements specify that neither party is to

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<sup>1</sup>See Preamble.

<sup>2</sup>See Notification From Parties, WTO WT/REG162/N/1, Jan.12, 2004, and Minutes of Meeting of the Council for Trade in Goods, WTO G/C/M/72, Jan. 26, 2004.

<sup>3</sup>See Table 1 of Annex 1, 273 goods covering medicines, and toys, among others.

introduce new quotas or other barriers towards bilateral imports. Neither party will use any-dumping actions against the other. CEPA allows for safeguards actions in goods trade after written notice, but these safeguards measures are seemingly not fully specified.

Bilateral liberalization of trade in services is specified in Annex 4 of both CEPAs. They each list 18 services sectors and specific bilateral commitments in each. The list includes (among others): management consulting, advertising, accounting, real estate and construction, logistics, freight forwarding, telecommunications and legal services. The agreement applies to financial activities, banking, insurance, and securities, and opens financial markets in the Mainland to entities from Hong Kong, CEPA for example lowers the required minimum assets for Hong Kong banks that establish branches in China from 20bn USD to 6bn USD.

A significant innovation in these agreements is that they define a new services entity, “a Hong Kong service supplier” (Annex 5) which opens doors to Chinese markets for international companies who can utilize this entity<sup>4</sup>. Benefits from the bilateral scheduled commitments in services only apply to this entity. To qualify, such a company must be established in Hong Kong for no less than three years (5 years for construction, banking, insurance, and related services), pay applicable profit taxes, have business premises (owned or rented) reflecting business activities in Hong Kong, and employ at least 50 % of the staff locally from Hong Kong permanent residents. The intended business in China must be the same as the company's substantive business in Hong Kong , and documentation is required to establish this.

For the purposes of the agreement CEPA recognizes service companies acquired by an overseas company as a Hong Kong service company one year after the merger or acquisition takes place. Any qualifying Hong Kong company operating in China must have Hong Kong Service Supplier Certificate issued in Hong Kong. Annex 5 excludes any overseas company registered in Hong Kong that is “specifically established for providing certain services to its parent company”, e. g. representative offices and “mailbox companies”.

Both CEPAs also provide for cooperation in tourism and mutual recognition of professional qualifications. In tourism the Mainland allows the residents of Guangdong to visit Hong Kong and Macao individually (at first on a trial basis in Dongguan, Zhongshan, and Jiangmen, then the entire province). The two countries also state their plan to promote bilateral tourism, jointly promoting programmes centred around the Pearl River Delta, and cooperate in raising the standard of services and protection of tourists. China and Hong Kong (Macao) aim to achieve mutual recognition of professional qualifications. Specific requirements and methodologies for qualification recognition are to be agreed through a consultative process with government authorities and professional bodies in the countries.

CEPAs contain trade and investment facilitation provisions under which China and Hong Kong (Macao) agree on seven areas of cooperation (trade and investment promotion, customs clearance facilitation, cooperation of small and medium sized enterprises, transparency in laws and regulations and others).

The overall coordination and implementation of each CEPA is the sole responsibility of a Joint Steering Committee who are to resolve disputes, and interpret provisions (Article 19). The

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<sup>4</sup> The Macao CEPA has a similar Macao service supplier company construct.

Committee comprises senior representatives or officials nominated by the two countries who will meet at least once a year. Special meetings can be held upon 30 days notice or request by either side. The functions of the Steering Committee include supervising the implementation of CEPA, interpreting the provisions of CEPA, resolving disputes, drafting additions and amendments to the content of CEPA, and supervising the working groups. All decisions of the Committee must be by consensus. Working groups of the Steering Committee are to be set up according to the needs of the parties and Liaison Offices are to be established both in the Chinese Ministry of Commerce and the Hong Kong Commerce, Industry and Technology Bureau (for the Macao CEPA, The Office of the Secretary for Economy and Finance of Macao Special Administrative Region Government).

In August 2004, further details of the arrangement between China and Hong Kong going beyond what was in the original CEPA were agreed and took the form of a Record of Consultation on Further Liberalization under the Mainland and Hong Kong CEPA. This document states that progress on implementation of CEPA has been smooth and has had a positive impact on both economies, and then expands on the earlier agreement between the two sides.

In goods trade China agrees to apply zero tariffs to the next stage of goods imported from Hong Kong at the beginning of next year (2005). This includes 713 goods (and applies to both existing and planned production) covering food, chemical, mechanical and electronic products. Rules of origin for these goods (which maybe slightly different from those in the original CEPA) are to be concluded no later than October 2004.

In services trade China offers to further relax market access conditions for Hong Kong service suppliers (but without precisely specifying what relaxation is involved). This includes the 11 sectors already specified in the original CEPA, and 8 new sectors including (among others): airport, information technology, job intermediaries, and marketing services. Most of these new commitments are to be implemented in January 2005.

The reaction to and comment on both of the CEPAs has been that since Hong Kong (Macao) is already one of the most open economies in the world and does not apply any significant barriers towards goods and services imported from China, each CEPA is effectively a one sided series of concessions by Beijing<sup>5</sup>. Before signing the agreement only about 20% of all goods trade from Hong Kong to China were tariff free (it was 90% in 2004 after CEPA implementation)<sup>6</sup>. To the extent this is the case, one can argue that China gains little from the CEPAs on the trade front except for the freedom from anti-dumping actions by Hong Kong (Macao) against China.

But these CEPAs will likely have a larger impact on services trade and here joint interests come into play. In most of the specified sectors Hong Kong (Macao) service companies will gain improved access to Chinese markets and sooner than those from other countries waiting for the implementation of China's WTO accession commitments. China promotes Hong Kong service providers over third country competitors, and given the closeness of the relationship involved and with eventual reintegration this may be seen in China as in the Chinese interest. A issue skeptics might arise is whether local regulations in China may anyway prove to be the binding

<sup>5</sup>See Business Asia, July 14, 2003.

<sup>6</sup>See EIU ViewsWire, Sep. 30, 2003.

restriction for Hong Kong companies operating in Mainland and CEPAs provisions in reality will be of little importance.

China also may be planning to use the CEPAs to attract Hong Kong (Macao) professionals to its services markets so that they can then train Chinese workers<sup>7</sup>. New rules for individual tourists coming to the Mainland from Hong Kong are also seen as a way of bringing the bilateral relationship closer in addition to immaculate economic benefits. While these CEPAs may be largely another step in Mainland – Hong Kong (Macao) integration but without too much of an impact on the Chinese economy before China – WTO agreements comes fully into force in 2007, but they are nonetheless precedents for further Chinese regional agreements.

### **3. The ASEAN – China Agreement**

China and ASEAN signed a Framework Agreement on Comprehensive Economic Cooperation in November 2002. It is less concrete than the CEPAs and only sets out a broad framework for more detailed agreements that are to follow. It contains 21 pages of text and 4 annexes. Its main stated objectives are: economic, trade and investment cooperation, progressive liberalization of trade in goods and services, creation of a liberal and transparent investment regime, and closer economic integration within the region<sup>8</sup>.

Under the agreement the parties have agreed to work towards the establishment of a Free Trade Area (FTA) between China and ASEAN within 10 years, but precisely what this FTA will comprise and what its institutional underpinnings will be remain for now unclear. What will be sought in CAFTA will be elimination of tariffs and non-tariff barriers in goods trade, liberalization of services trade, promotion of bilateral investment within the FTA, and simplification of customs procedures and the establishment of mutual recognition arrangements. The China-ASEAN Agreement has not been notified to WTO, but the eventual CAFTA will presumably be.

Under the agreement, China and ASEAN FTA (CAFTA) with the original ASEAN 6 (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) is to be established by 2010 and by 2015 with the newer ASEAN members (Viet Nam, Lao PDR and Myanmar, Cambodia). Bilateral tariffs will be lowered to 0-5% on most goods, and non-tariff barriers are to disappear.

The goods subject to reduction/elimination, along with tariff rates and schedules (involving both a Normal and a Sensitive Track as per Article 3, Paragraph 4 of the agreement) and rules of origin are to be negotiated by the parties, and spelled in more detailed agreements to follow. Any bilaterally agreed safeguard arrangements and disciplines on subsidies, anti-dumping measures are to be based on existing GATT disciplines and are also to be elaborated.

As far as trade in services is concerned, the parties plan to negotiate progressive elimination of all discrimination in new and existing service restrictions (unless permitted under GATS). In the investment area, the parties are to liberalize their investment regimes, strengthen cooperation, and improve transparency of rules and regulations.

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<sup>7</sup>See China Staff, Feb. 2004.

<sup>8</sup>See Preamble

A key element in the 2002 ASEAN-China agreement is an Early Harvest Programme set to start in 2004 (Annex 1). The Programme will cut tariffs ahead of the planned establishment of the CAFTA in 2010 (it is also called a “trial move”). Eight categories of agricultural products (about 600 different goods) with exclusions are itemised in Annex 1. Depending on the product category involved, zero tariffs between China and ASEAN 6 under the Early Harvest Programme are to be in place at the latest by 2006, and not later than 2010 between China and the newer members of ASEAN.

The only ASEAN country not to participate in this Early Harvest Programme is the Philippines who argued that their agricultural sector could not withstand the liberalization (one issue is illegal imports of Chinese agricultural products in the Philippines). Additional goods can be added to this programme by negotiation (between China and individual ASEAN members).

The agreement also covers other areas of possible bilateral cooperation outside of trade in goods and services (Part 2). The parties agree to cooperate (in as yet unspecified ways) in agriculture, information and communications technology, human resources development, investment, Mekong River basin development, banking, finance, transport, energy development, tourism. All discussions on cooperation are to take place in the ASEAN-China Trade Negotiation Committee. Cooperation will also cover promotion and facilitation of trade and investment through agreed standards (and conformity assessment); agreement on technical barriers to trade and non-tariff measures, customs cooperation; increasing the competitiveness of small and medium enterprises, promoting electronic commerce, capacity building, and technology transfer<sup>9</sup>.

Under CAFTA the Chinese markets covered by the early harvest programme will be opened for ASEAN countries ahead of the schedule negotiated for goods trade more broadly under China's WTO accession agreements. Trade between China and ASEAN continues to grow but still represents only 3% of exports and 5% of imports for the ASEAN 6. China will gain from more open markets for her manufacturers and a more stable supply of raw materials (ASEAN is China's fourth largest supplier)<sup>10</sup>. The CAFTA may also bring faster liberalization within the ASEAN itself as non-tariff barriers affecting goods and services trade towards China are removed.

China's 2002 Framework Agreement with ASEAN was initially seen as largely symbolic, but that perception has changed as China has pushed strongly in negotiations on the Annexes to the Agreement. ASEAN is China's fifth largest trading partner, and China clearly hopes to strengthen her position in ASEAN markets. In China, the argument is made that CAFTA may be the first step for China in creating an economic counterforce to the US and Europe and may also help in any future negotiations on creating an all-Asian FTA.

Two-way trade between China and ASEAN increased by 40% in 2003<sup>11</sup>. In January 2004 it increased a further 15.4% year-on-year (6.4 billion USD). China's exports to ASEAN reached 8.1 billion USD in the first quarter of 2004 (up 31.9% year-on-year); imports increased to 13.8 billion USD (up 42.5%). China's imports of fruit and vegetables from ASEAN (where tariff cuts under the Early Harvest Programme occurred) increased by 38.7% year-to-year in the first six

<sup>9</sup>See Article 7, Paragraph 3.

<sup>10</sup>See M. Vatikiotis, Far Eastern Economic Review, July 1, 2003.

<sup>11</sup>See Bo Xilai in China Daily, Sep. 5, 2004.

months of 2004; exports increased 33.9%<sup>12,13</sup>.

#### **4. Chinese Regional Agreements with Australia and New Zealand**

Besides the CEPA agreements and CAFTA China has also signed two broad initial framework agreements with Australia and New Zealand. These set out the emerging structure of trade, investment, and the wider economic relationship with two OECD countries in the region, and may indicate how China plans to proceed in regional agreements with other OECD countries.

##### ***Australia***

A Trade and Economic Framework between Australia and China was signed in October 2003. This sets out areas of future cooperation which aim to “achieve balanced and comprehensive trade and investment facilitation and liberalization”<sup>14</sup>. The text is brief. It contains 3 pages and has 2 Annexes (Annex 2 is 6 pages long). Paragraph 2 and Annex 1 indicate the specific areas where the parties will promote strategic cooperation and seek to create favourable conditions for trade and investment.

In energy and mining, China and Australia state their wish to improve their joint regulatory and policy climate, cooperate in training, research and development, and promote business linkages and exchanges. Also, arrangements will be concluded on a Natural Gas Technology Partnership Fund to enhance mutual understanding in the field of clean energy.

In textiles, clothing, and footwear China and Australia commit to hold regular trade fairs and exhibitions, encourage the development of business links and contacts, and support joint ventures and joint development of brands.

In agriculture and quarantine inspection China and Australia will cooperate further under existing agreements (e.g. the 1984 Agreement on Agricultural Cooperation and the 1984 Protocol on a Program of Cooperation in Agricultural Research for Development) and conclude other MOUs and Protocols (a Plant Quarantine Protocol on Australian Wheat and Barley Imports into China, a MOU on Cooperative Activities in Water Resources, and a MOU on Cooperation on Sanitary and Phytosanitary Matters).

They will also strengthen communication and consultation mechanisms regarding quarantine procedures to improve transparency and facilitate compliance and trade. The text is not detailed, but mentions a dialogue on quarantine management regulations, registration policies and other practices, consultation on food safety inspection and certification issues, and concrete actions to facilitate business and commercial linkages and exchanges.

Investment between the two countries will be enhanced through information exchanges,

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<sup>12</sup>See Zhang Jin, China Daily, Apr. 8, 2004.

<sup>13</sup>The first country to experience zero tariffs in China under the Early Harvest Programme was Thailand from June 2003 (went into force in October 2003). Thailand's exports of vegetables increased in the first quarter of 2004 by 38%, and fruit by 80%. Thailand's exports of fruit and vegetables accounted for over 60% of ASEAN's total exports to China in the first half of 2004.

<sup>14</sup>See Paragraph 1.

improved transparency and predictability of measures, and protection of investors and investments. The parties also commit to build institutional linkages between Australian and Chinese government agencies to promote cooperation and consultation.

In the services area the parties plan to cooperate on education and training through mutual recognition of professional qualifications, joint labour services, and facilitation of travel for Chinese personnel to Australia. The parties also plan to work together on engineering, resources and mining development projects. There are few details but the possibility is raised of Chinese firms investing under contract in Australian projects in these fields.

In information and communications technology and e-commerce, the two countries plan to intensify their cooperation under an existing 1999 MOU. The countries will promote a dialogue between their customs agencies to simplify and facilitate trade, promote the development of e-commerce, and enhance cooperation in law enforcement. In intellectual property, the countries state their wish to cooperate and to work together bilaterally, regionally and multilaterally. In matters of public health, the countries plan to cooperate under an existing 1993 MOU on Health Cooperation. The countries will also conclude a MOU on cooperation in food safety.

In the area of technical barriers to trade, the countries will seek to improve trade facilitation by concluding a bilateral understanding supplementing multilateral commitments for quality supervision, inspection and quarantine, and strengthening communication and consultation mechanisms. They will also strengthen cooperation in standards, certification and accreditation including exchanges between officials and experts, and conclude a mutual recognition agreement covering mechanical and electronic products.

The countries will also explore possibilities for improved facilitation of visa procedures for both work and business visas, support industry and business groups working on strengthening bilateral trade, and in the anti-dumping area the countries plan to set up bilateral mechanisms for anti-dumping notification so that any conflicts can be better resolved through dialogue and consultation.

The Framework also stresses the importance of regular bilateral meetings, and their wish to strengthen the existing Joint Ministerial Economic Commission. Australia and China also agree to a Joint Feasibility Study in which the parties will explore the possibilities for a formal FTA<sup>15</sup>. This Study is to provide an overview of recent trends in bilateral trade and economic relations, assess recent international trade policy developments and the possible implications for Australia-China trade and investment, identify and describe existing barriers to trade and investment flows (in goods, services, and investment), identify possible cooperation measures to promote trade and investment liberalization, assess the impact of the removal and/or reductions of existing barriers in trade of goods and services, investment, and make recommendations re options for future action. The study is to be completed by end of 2005. The Agreement also states that any future FTA talks can only proceed on an “equal basis”. Before the FTA negotiations start, Australia will consider recognizing China as market economy which is important to China in its dealings with antidumping measures in countries, such as the US, who use different procedures against exporters designated as non-market economies.

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<sup>15</sup>See Annex 2.

China is currently the second largest trading partner of Australia (China overtook the US last year), and Australia is China's ninth largest partner. In 2003 Australia had a trade surplus with China of over 13.5 billion USD reflecting exports of iron ore, copper, and petroleum<sup>16</sup>.

### **New Zealand**

China and New Zealand signed a Trade and Economic Cooperation Framework Agreement similar to that with Australia in May 2004. In this, the parties state their interest in seeking “comprehensive trade and investment facilitation and liberalization through all-round economic and trade cooperation”<sup>17</sup> and also agree areas of further negotiation.

Paragraph 2 lists specific areas of “significant mutual economic potential” where the countries will promote strategic cooperation. Annex 1 contains the details. In agriculture, animal husbandry, forestry, biosecurity, food safety, the parties will strengthen cooperation and further development of Joint Commissions established in 2001. In wool, development of trade will be promoted using the trade organizations in the countries. New Zealand also offers to help China through training and technological cooperation in these areas.

In science and technology, the parties will further develop an Agreement on Cooperation in Science and Technology signed in 2003. They will also seek to enhance cooperation between the two countries research and innovation communities.

In technical barriers to trade, the parties plan to base their cooperation on the WTO/TBT mechanisms. The issue is how to strengthen communication and consultation on technical and inspection regulations and standards so that reductions in costs to business are achieved. The aim is to conclude a cooperative framework programme for quality supervision, inspection, standards and conformity assessment, and also to enhance arrangements for consultation between certification agencies to support recognition of each other's testing and certification requirements. The aim is also to enhance cooperation in WTO-related training for Chinese personnel. The plan is to utilize the China-Australia-New Zealand Standard Wool Contract, establish liaison channels, enhance contacts and linkages, and adopt administrative measures to deal with outstanding issues.

In information and communication technology and e-commerce, the two countries will encourage cooperation through the development of a memorandum of understanding. In services the parties will seek to expand trade in services and explore possibilities for cooperation, especially in education, tourism, air services, and labour and professional services. In investment the parties aim to increase investment volumes by exchanging information, enhancing transparency and predictability, protecting investments and investors, and building institutional linkages to promote investment visits, B2B initiatives, conferences, and other innovations.

The agreement also covers environmental protection. The two countries agree to share information and cooperate on promoting environmental protection, resource management, and protection of biodiversity. The countries also stress the importance of intellectual property rights and plan to also cooperate in this area.

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<sup>16</sup>See China Daily, Aug. 18, 2004.

<sup>17</sup>See Paragraph 1.

In customs cooperation, the countries plan to update the existing 1995 Cooperative Arrangement with new initiatives on trade facilitation and security. They will promote communication between customs administrations, electronic commerce strategies, and information sharing. They also recognize the importance of strengthened law enforcement and cooperation to prevent customs offenses. The countries plan to simplify application procedures for business visas, shorten processing times, and facilitate long term working visas for business travellers.

As with the Australian Framework Agreement there is stress on the importance of regular bilateral meetings between leaders and ministers. The countries will establish a Joint Ministerial Commission as a forum for a dialogue on joint trade and economic issues. China and New Zealand will also strengthen both the position and role of the Joint Trade and Economic Commission and other sectoral Joint Commissions.

Unlike Australia, New Zealand immediately recognizes China as a market economy and agrees not to implement any anti-dumping measures against China under the sections 15 and 16 of the WTO accession protocol, and paragraph 242 of the Report of the Working Party on China's accession to the WTO. The parties commit (as with Australia) to undertake a Joint Feasibility Study<sup>18</sup> on a bilateral Free Trade Agreement and commence negotiations on establishing a FTA as soon as possible (possibly in early 2005).

China – New Zealand FTA negotiations will be the first China will start with a developed country, and there are clear reasons for China choosing New Zealand in this way. New Zealand has a one-China policy, recognized China early in the 1970's and reached early agreement on China's accession to WTO<sup>19</sup>. New Zealand has also become the first developed country to recognize China as market economy.

China is New Zealand's fourth largest trading partner, and the third largest purchaser of lamb and dairy, and fifth largest of forest products<sup>20</sup>. China-New Zealand trade was 1.8 billion USD in 2003, with over 30% growth year-to-year. For China an FTA with New Zealand is a precedent for other FTA negotiations China might conduct with other developed countries<sup>21</sup>.

## 5. Other Potential Chinese Regional Agreements

While formal agreements involving China are limited to the two CEPA agreements, ASEAN, Australia, and New Zealand, several others are seemingly in process with negotiations likely to be launched soon.

A key case is India. There is no official text of any pre-FTA agreement between India and China so far, but both countries appear to be moving towards FTA negotiations. In the past there have been disputes regarding borders issues between the countries, but it now seems that they now share common interests in trade and also in WTO matters.

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<sup>18</sup>See Annex 2.

<sup>19</sup>See Colin James, Far Eastern Review, Apr. 22, 2004.

<sup>20</sup>See Chen Mingming, The New Zealand Herald, Aug. 31, 2004.

<sup>21</sup>See Stuart McMillan, The National Business Review, July 2, 2004.

After the Indian Prime Minister's visit to China in June 2003 a joint Declaration was signed. In the Declaration the two countries noted their mutual desire for good bilateral relations, and their common interests. In the area of trade, China and India plan to take measures consistent with the national laws and international obligations to remove impediments to bilateral trade and investment<sup>22</sup>. China and India have started discussing possible bilateral trade arrangement on preferential tariffs (more preferential than the MFN tariffs) on a range of products: including paper, steel, chemicals, and food. The list includes 217 Indian exports and 188 Chinese exports facing lower than average tariffs in the other market<sup>23</sup>. In June 2003, the two countries agreed to form a Joint Study Group to explore the potential for expanded bilateral trade and cooperation<sup>24</sup>. The resulting India-China Group met in March 2004 with the aim of preparing a five year blueprint for enhanced bilateral trade and cooperation to present to the two governments<sup>25</sup>.

The first meeting discussed possibilities for both a comprehensive economic cooperation agreement and a India-China free trade agreement. The Group is to present its findings by the end of 2004<sup>26</sup>. A second meeting of the Joint Group was held in July 2004 in New Delhi with the aim of fostering cooperation between the two business communities<sup>27</sup>.

Chile and China officially announced in April 2004 plans for a feasibility study regarding the possibilities for strengthening trade and economic cooperation, and a possible free trade agreement. The study is to evaluate the possible impacts of a free trade agreement between the two countries in different sectors and on overall economic relations. The group working on the study is composed of specialists from the Chinese Ministry of Foreign Affairs and Chilean DIRECON (General Directorate of International Economic Affairs – government agency) with experts from ministries of finance, economics, agriculture, mining and transport, and the central bank<sup>28</sup>. The study will cover goods, services and investments; the study is to be presented not later than October 2004. It is expected the negotiations towards the FTA between China and Chile will start this year during the November APEC meeting in Chile. Also, at this meeting Chile will probably announce their recognition of China's market economy status.

Chile is China's third largest trade partner in South America and due to large imports of copper and pulp China has a trade deficit with Chile. Chinese exports to Chile are mainly limited to low-value manufactured goods (textiles and footwear). A FTA will help China further develop the Chilean market and creates the possibility of further penetration of South American markets.

There are opinions that China chose Chile as their first possible FTA partner in South America because Brazil is currently undergoing economic reforms and restructuring, and also because Chile is not as economically tied to the US as Mexico. Chile's economy depends heavily on foreign trade and 75% of Chile's foreign trade is currently covered by various FTAs (including Canada, the US, the EU, Norway, Finland, Mexico)<sup>29</sup>.

A further area of bilateral activity for China is South Africa. In June 2004 China and

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<sup>22</sup>See The India and China Declaration on Principles for Relations and Comprehensive Cooperation. June 23, 2003.

<sup>23</sup>See Deccan Herald, July 26, 2003.

<sup>24</sup>See S. Sethuraman, The Kashmir Telegraph, Aug. 2003.

<sup>25</sup>See Outlook India, Mar. 22, 2004.

<sup>26</sup>See P.S. Suryanarayana, The Hindu, Mar. 24, 2004.

<sup>27</sup>See India Daily, July 26, 2004.

<sup>28</sup>See Press release, Ministry of Foreign Affairs of Chile, Apr. 27, 2004.

<sup>29</sup>See Wang Li, China Daily, May 10, 2004.

South Africa issued a joint communiqué in which South Africa granted China market economy status. In the communiqué, China and South Africa also announced their plan to launch FTA negotiations. In the declaration, the two countries stated they would work on encouraging bilateral trade and investment and expanding cooperation in “areas of mutual economic interest”<sup>30</sup>.

There is also bilateral activities with the Middle East. In July 2004 China and the Gulf Cooperation Council (UAE, Bahrain, Kuwait, Oman, Qatar, and Saudi Arabia) announced in a joint communiqué that they had signed a Framework Agreement on Economic, Trade, Investment and Technological Cooperation. Under this, the two countries agree to encourage cooperation and technological exchanges, expand trade, and promote mutual investment. They also establish a joint committee for cooperation to implement the agreement and create a consultation mechanism. Furthermore, China and the GCC agree to launch negotiations on a Free Trade Agreement (the dates have not yet been set)<sup>31</sup>.

If established a China-GCC FTA would be the second Chinese agreement with a regional group, the ASEAN agreement being the other. China's aim would be to benefit from secure oil imports from the Gulf countries and expand exports of garments, fabrics, and electronics to the region. China also seeks increased GCC investment in water and electricity supply, energy and mineral industry, transportation, communication, and closer cooperation in scientific and technological research<sup>32</sup>.

Elsewhere in Asia, Singapore and China have started consultations on a possible FTA after China concluded the ASEAN Agreement. Talks were scheduled to start in November 2004, but now it seems that China wants to delay them following the Singapore Deputy Prime Minister's visit in Taiwan in September 2004<sup>33</sup>.

## **6. Evaluating Regional and Multilateral Objectives in China's Trade Policy**

In embarking upon negotiation of this ever-growing network of regional trade agreements China has followed a path similar to that chosen by the other large entities in the trading system (the US and the EU). A striking feature of the Chinese approach, however, is the speed at which this both has been and is being done given accession to the WTO only occurred in 2002. Equally striking is the seeming difference in the structure of these regional agreements compared to those of the US and the EU. Recent US and EU bilateral agreements tend to follow a common template structure. Not only is the template different in the Chinese case, it is much more varied making the eventual emergence of an Asian trading bloc centred around these arrangements problematical. This seemingly reflects both a pragmatism in recognizing differences across partners, but also the clear linkages being established between seemingly conventional trade interests and China's interests in wider economic, diplomatic and strategic relationships. The approach seems to be one of pragmatic management of a series of bilateral relationships in customized manner, in which conventional economic and trade agreements, such as tariff based free trade areas of customs unions, are merged into broader more encompassing relationship

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<sup>30</sup>See China and Chile Joint Communiqué, June 29, 2004.

<sup>31</sup>See China and GCC Joint Communiqué, July 7, 2004.

<sup>32</sup>See Bo Xilai, Ministry of Commerce release, July 9, 2004.

<sup>33</sup>See Agence France Presse, August 3, 2004 and July 25, 2004.

building rather than precise narrower legal text.

A natural question to ask is whether this course of action is in the Chinese interest. If China is so firmly committed to multilateralism and WTO disciplines as is often espoused, then why is China not content to leave the setting of its trade agreements with regional partners simply to WTO disciplines and process? And why negotiate in this varied way with different partners?

A first response to these questions is to note the conflicting interests of all larger powers in both multilateralisation in abstract, and in the WTO trading system in its present compromised multilateral guise. The incentive of the large powers given the present system is seemingly to both espouse and abide by WTO non discrimination and MFN in their trade relationships with each other, trying to firm up non discriminatory access to large markets and also to share in benefits negotiated by other large powers in third markets, while at the same time using their asymmetry in power to negotiate preferential agreements with local smaller partner countries. This suggests an inevitability to a two tier international trading system of common multilateral disciplines involving all countries, and largely reflecting the interests of large powers in their arrangements with each other, and regional disciplines going beyond multilateral arrangements and reflecting the dominant interest of a large power in any given smaller market. This seems the reality of the WTO system in place today.

If this position is accepted, along with an inherent asymmetry in power between large and smaller countries, then the coexistence of both multilateral WTO disciplines and a supplementary system of regional disciplines becomes an inevitability. From China's point of view, then the issue is what form of regional agreements should be negotiated, not whether they should be negotiated.

This leads naturally to the issue of whether the form of and modality for these negotiations fits China's interest? Seemingly in proceeding sequentially by country, and in first negotiating with Hong Kong where the form of agreement can be more easily shaped than in other cases and the precedent then used in subsequent negotiations the approach seems to fit the national interest well. Precedent can be established in early simple cases, much like early US bilaterals with Singapore and Chile in their recent wave of negotiations. And the twin objectives of building towards a regional structure in Asia, and in negotiating with entities other than the US and the EU so as to enhance negotiating power with other large entities in the WTO seems to be in the natural interest.

Also using a structure of initial framework negotiation with sequential elaboration through further negotiation more concessions may be eventually extracted, and learning as negotiations proceed can occur seems to fit well. Equally, the absence of formalized dispute settlement, and reliance on conciliation would seem to fit the Asian way. And in customizing agreements to fit partner characteristics, prior elements of the relationship, and strategic considerations, the Chinese approach to bilateral commercial engagement seemingly displays a pragmatism less evident with the US and the EU.

Thus where questions arise lie more with the coverage of these agreements. Compared to the regional agreements negotiated by the EU and the US, China's regional agreements are more centrally focused on the conventional WTO spheres of trade in goods and services. Other non

WTO areas such as special sectoral arrangements, possible tax harmonization, innovative dispute settlement, coverage of environment and non-trade matters, and financial integration as appear in NAFTA and the Treaty of Rome are seemingly less central to these agreements in their present form. While this may change, it may for now reflect both the present structure of China's international economic engagement, and a desire to appear as WTO compatible as possible in these agreements (given the incomplete nature of China's WTO accession process). But as China's trade patterns and interest in her interaction with other economies evolves this may change. Thus in not being forward looking in terms of coverage of future interests these agreements may be less reflective of China's interests.

## 7. Concluding Remarks

This paper discusses the emerging network of regional trade agreements that China is now involved in negotiating following her accession to the WTO in 2002. An initial and subsequently elaborated free trade agreement with Hong Kong has been concluded and notified to WTO. A similar agreement with Macao is in place. Initial agreements also exist with ASEAN, Australia, and New Zealand, and discussions are underway with India, South Africa, Singapore, the Gulf Cooperation Council, and others.

The paper highlights the main features of these agreements; their relative brevity, the substantial differences between them, their focus more on trade in goods and services rather than non WTO matters, the absence of formal dispute resolution, and a negotiating style of initial agreements followed by subsequent elaboration rather than one-off treaty negotiation.

The paper concludes with a discussion of how the Chinese national interest may be served by these agreements, arguing that assymetries in size and power in the trading system seemingly produce an inevitable two tier system of large power non discriminatory arrangements reflected in common multilateral disciplines, and regional agreements negotiated by large powers with smaller countries going beyond these disciplines where the large power has the dominant interest. In this sense, the issue for China may not be whether they should have negotiated these agreements, but more how they chose to do so and the implications for the future negotiations.

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