

## China's Approach to the Free-Trade Area

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One of the unusual developments in China's foreign relations and Asian economy in recent years is that China, as still a developing country, has been actively pushing for free trade areas/arrangements/agreements (FTA) in Asia and the world. In just the few years since 2001, it has been busy suggesting and engaging in FTA talks and negotiations with a number of countries. It has signed a basic agreement with ASEAN (Association of Southeast Asian Nations) and has also engaged in serious negotiations with Australia to set up an FTA, and has begun talks with New Zealand. In Northeast Asia, China suggested an FTA arrangement among itself, Japan, and the Republic of Korea (ROK), and those three major economies have established a joint committee to study the possibility. At the same time, China has proposed FTA arrangements with the Shanghai Cooperation Organization (SCO) members: Russia, China, Kazakstan, Kyrgystan, Tajikistan, and Uzbekistan. China and Middle East countries have also expressed their willingness to consider establishing FTAs. Farther away, China has even proposed FTAs with Brazil and other Latin American countries.

The China FTAs are not the only ones the other Asian countries are pursuing. ASEAN is negotiating or studying FTAs among its members and with Japan, the ROK, India, Australia, and New Zealand. In short, there has been an "FTA boom" in Asia.

### China-ASEAN FTA

In November 2004, China and ASEAN signed agreements on Trade in Goods and on Dispute Settlement under the framework of the China-ASEAN FTA, aimed at phasing in by the end of the decade the world's largest free-trade area—a sprawling market of nearly two billion people, with a combined GDP of \$3 trillion. In July 2005, the tariff reduction process started on all fronts. China has agreed to establish by 2010 FTAs with Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand; agreements with Vietnam, Laos, Cambodia, and Burma/Myanmar are to be in place by 2015, by which time China and ASEAN will realize zero-tariffs for most products.<sup>1</sup> ASEAN will expand trade with China from about \$100 billion in 2004 to as much as \$140 billion by 2010. The agreement aims to bring tariffs below 5 percent in most of the 11 countries by 2010, and by 2012 for valuable products such as cars.<sup>2</sup>

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<sup>1</sup> Ding Qingfen, "ASEAN Trade Prospects Bright," *China Daily*, Sept. 7, 2006.

<sup>2</sup> "Rush Is on to Join Asean Trade Talks," *Asian Wall Street Journal*, Dec. 1, 2004; Eric Teo Chu Cheow, "ASEAN

The China-ASEAN FTA should further the results already seen with the “early harvest” program between China and some ASEAN countries. That program, launched in January 2004, offers preferential tariffs on more than 500 mostly agricultural products.

### **China-Japan-ROK - “The +3”**

The leaders of China, Japan, and South Korea have regular trilateral meetings, and the three countries have also developed regular ministers’ meetings on areas such as trade, finance, communication, and the environment. Thus, a subgroup of Northeast Asia has been developing within the ASEAN+3 process.

The +3 countries issued a Joint Declaration for Promoting Trilateral Cooperation when their leaders held their fifth summit at the ASEAN+3 meeting in October 2003 in Bali. The Declaration pledges further cooperation and dialogue on economic, cultural, educational, environmental, political-military, and security issues, and the leaders agreed to set up a trilateral committee to promote and implement the cooperative agreements.

The three Northeast Asian countries have a strong basis for developing trilateral cooperation. First, they are closer to each other in geographic and cultural points of view than they are with the countries in Southeast Asia. Second, they have closer trade and economic relations with each other than they have with ASEAN. Trade between China and Japan reached \$184 billion in 2005, while Sino-ROK trade expanded to \$112 billion. Japan and the ROK have each invested around \$40 billion in China.<sup>3</sup> Therefore, there is the need, demand, and rationale for official and stronger integration among the three.

Beijing proposed an FTA with Japan and the ROK at the +3 meeting held in November 2002 in Cambodia, and the three are studying this possibility. The process will be no quicker than other Chinese FTAs, because economic and political gaps among the three countries, especially between Japan and the other two, are wide. Japan has a more developed economy than those of Korea and China, and it fears the inflow of cheaper goods, especially agricultural products. Also, Japan has historical and territorial disputes with both Korea and China which sometimes have become hot political and emotional issues among the +3 countries. Therefore, while Chinese officials and analysts tend to support the idea of a Northeast Asian FTA (NEAFTA), the lack of trust between Japan and the other two Northeast Asian countries prevents the three from becoming a meaningful economic grouping anytime soon.<sup>4</sup>

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Summit Pushes Co-op,” *China Daily*, November 26, 2004.

<sup>3</sup> Academy of International Economy and Trade Studies (Beijing)’s *International Trade*, No. 2, 2004, p.60-62.

<sup>4</sup> See Dai Yan: “Study Backs Free-trade Zone,” *China Daily*, June 2, 2003.

## **An East Asia FTA?**

China also proposed a study on the feasibility of an East Asia FTA at the October 2003 summit in Bali, and reiterated this at the November 2004 summit in Laos. While there has been little progress on this, talks about a number of partial FTAs--China-ASEAN and Japan-ASEAN--have been underway. An East Asia region-wide FTA (EAFTA) could be built upon these processes if the bilateral talks are successfully completed and implemented.

## **China's Political Motivation**

China's move toward FTAs does not stem primarily from economic considerations. Trade and other economic interests are naturally partially behind the move, but what Beijing cares most about are the political relations that the economic relations will bring about. As far as trade and economics are concerned, Southeast Asia is not the most important area for China. The U.S., European Union, and Japan trade with China more than Southeast Asia does. Nor do China's FTA efforts come from careful calculation of the potential gains and losses from the arrangement.

China's relations with its Asian neighbors are the most immediately important part of its foreign relations. Therefore, China would like to do whatever it can to improve its relations in Asia. Second, the Chinese realize that their country's rise has caused unease in other countries, which see it as an economic threat. China does not worry too much about the "China threat" perception when it comes from Washington or Tokyo, because most the Chinese believe that this is a strategic ploy of the U.S. and Japan, to cause friction between rising China and other countries. But when the "China threat" concern comes from Southeast Asia or other smaller countries in Asia and the world, then Beijing takes it seriously.

What can China do? Certainly its leaders and officials can keep insisting that it is not a threat but an opportunity to others, especially to smaller developing countries. But the Chinese know that in addition to statements and gestures, they need to do something real. An FTA is something concrete that China can do to show the goodwill and benefits that it can give to others. The Chinese hope that FTAs between China and other Asian countries will increase the latter's trade with China and benefits from the rising Chinese economy.

## **Economic Confidence**

Countries can gain a lot from FTAs, but they also may lose a great deal from them, especially in FTAs with developed nations. Beijing understands this risk when it proposes FTAs with other countries, especially with Japan and the ROK, whose economies are much sophisticated than the Chinese. Beijing is taking the risk because it is confident that China will not lose, or at worst will lose little, from the FTA. More

than two decades of rapid economic growth makes it confident in foreign trade and the international market. As the world's third-largest trader, the Chinese believe they can do well in a free-trade environment.

China also understands its competitive advantages, the biggest of which is its labor force. China has the largest and cheapest labor force in the world, which permits it to produce everything at a lower cost. In free competition in the international market, China would benefit more than other countries.

### **Economic Interests**

China's long-term trade relations strategy is to reduce its dependence on the West and increase its trade with the East, including Asia, Russia, the Middle East, Africa, and Latin America.

Another motivation for its FTA bids is investment. China expects that FTAs with Asian countries will not only increase trade, but also promote investment. In recent years, the Chinese government encouraged the business community to "go out," to increase Chinese investment abroad in order to do business in international market, obtain the resources that China needs, and avoid trade conflicts with other countries.

### **Encouraging Multilateral Experience**

China was long one of the most reluctant, passive, and negative powers when it came to regional multilateralism in Asia. But since the late 1990s, it has become one of the most active players. There are a number of reasons for this shift. First, since China has gained more experience in multilateral institutions, it understands them better and has become more mature and confident regarding them. When China entered the multilateral process in the early 1990s, it was fearful and cautious. It felt based on its Cold War experience that multilateral institutions such as the UN, NATO, the Warsaw Pact, and SEATO (Southeast Asia Treaty Organization), were the instruments of major powers and slighted its interests. Between 1950 and 1953, China fought in Korea against a UN army, led by the United States and including fourteen other countries. The "UN Army" still remains in Korea. Therefore, as China entered multilateral institutions, it feared that they might be used by the United States or others to hurt it, to discuss issues related to China, and to criticize Chinese policies, especially on critical security issues, such as the South China Sea and Taiwan.

Its actual experience of participating in multilateral institutions in recent years has given it more confidence. The Chinese have been able to keep issues related to China out of the institutions' discussions. Therefore, they have become much more comfortable with regional groups such as the ARF (ASEAN Regional Forum). China has found that it can even benefit from the multilateral processes. ARF, APEC, CSCAP (Council for Security Cooperation in the Asia Pacific), and four-party or

six-party talks all provide a good opportunity for China to explain its policies and exert influence in the region. Second, the multilateral processes lets China demonstrate *zhengxin shiyi* (increasing trust and decreasing suspicion).

Many Chinese officials, businesspeople, and scholars, as well as the public, believe that multilateral cooperation and regionalization in East Asia is an inevitable trend. Prof. Zhao Huaipu at the Foreign Affairs University in Beijing argues that booming East Asian cooperation--buoyed by the success of EU, the North American Free Trade Agreement (NAFTA), and the African Union (AU)--is becoming a precursor of Asian integration. The 1997 financial crisis was critical in forging awareness among East Asian nations that they have no choice but to stand together. "The formation of the ten minus three framework ... has shown a collective resolution to overcome negative factors caused by globalization."<sup>5</sup>

### **FTA Experience to Date**

In September 2006 Chinese officials expressed confidence that the agreement to establish an FTA has helped its trade with Southeast Asian countries grow. In 2004, China-ASEAN trade volume rose by 35 percent from the prior year, reaching \$105.9 billion--surpassing the goal of topping \$100 billion by 2005. ASEAN is China's fifth largest export market and the third largest import source. China has also become the fourth-largest trading partner of ASEAN. The FTA process has also brought efforts by the two sides to strengthen their economic ties. Over the next three years, one-third of the loans China plans to offer to developing countries will go to ASEAN member states. China will also provide loans worth \$5 billion to Chinese companies aiming to expand business in ASEAN countries.<sup>6</sup>

The FTAs currently under negotiation between China-ASEAN Japan-ASEAN are very important and meaningful steps for East Asia to establish a real economic grouping.

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<sup>5</sup> Zhao Huaipu, "Speeding up East Asian Integration," *China Daily*, Oct. 22, 2004. Also note Hanns Maull's less optimistic conclusions in this volume

<sup>6</sup> Qingfen, "ASEAN Trade Prospects Bright."