

## China's Free Trade Agreement Strategies

The Trans-Pacific Partnership (TPP) is a multilateral free trade agreement (FTA) which aims to liberalize the economies of the Asia-Pacific region. The rapid movement of the TPP agenda, however, has caused China some disquiet. Originally, the agreement was signed among four countries (Brunei, Chile, New Zealand and Singapore) on June 3, 2005, and entered into force on May 28, 2006. In 2008, five additional countries (Australia, Malaysia, Peru, the United States, and Vietnam) began negotiations to join the group.<sup>1</sup> On November 12, 2011, the leaders of these nine TPP partner countries announced the broad outlines of an expanded TPP: it will promote innovation, enhance economic growth and development, and support the creation and retention of jobs among the nine dynamic Asia-Pacific economies.<sup>2</sup> Further negotiations are still underway, with Japan, Canada, and Mexico also having demonstrated a strong interest in joining.

China actively promotes the regional economic integration of East Asia, which depends heavily on external neighboring economies. The TPP agenda is considered by many Chinese policymakers and scholars as a force that could rip apart the regional economic integration of East Asia.<sup>3</sup> Moreover, a strong voice in Chinese academic and policy circles maintains that the main reason behind the Obama administration's support for the TPP agenda is a desire to use it as a tool to economically contain China's rise.<sup>4</sup>

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**The TPP agenda is considered by many a force that could rip apart East Asian economic integration.**

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Given the high financial, economic, and security stakes of TPP negotiations, this paper aims to introduce China's evaluations of the TPP agenda, articulate the possible strategies Beijing might use to respond to TPP's rapid movement, and discuss the constraints and limitations of China's corresponding FTA strategies as well as show how these strategies will affect the world trade system in the long run.

### **China's Evaluation of TPP**

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China did not pay much attention to TPP when the first countries signed in 2005. When Washington decided to join the negotiations, however, Beijing's interest grew. When the United States released its official proposal of the TPP negotiation agenda—something that demonstrated that the TPP agenda had evolved from an idea to an important policy initiative—at the Hawaii APEC Summit in 2011, the Chinese academic community responded. Scholars conducted a comprehensive evaluation about the U.S. intention to promote TPP negotiations, as well as the agreement's possible effect on China.

#### **Views of U.S. Intentions**

As the TPP agenda moves forward, several Chinese scholars have argued that the United States' main intention behind joining negotiations is simply to boost its domestic economy via increased exports in the Asia–Pacific region. Du Lan, a researcher at the China Institute of International Studies (CIIS), suggests that the United States' real intention is to restructure its economy, boost its exports, benefit from East Asia's rapid economic growth, and buoy its economic recovery.<sup>5</sup> Wu Zhenglong, Secretary-General of the China National Committee for Pacific Economic Cooperation, notes that by “doubling exports over the next five years and creating two million new jobs, the United States is eager to open its domestic market towards more Asia–Pacific countries and lower tariffs through the TPP platform.”<sup>6</sup> Pang Zhongying, a professor at the Renmin University of China, also says that “TPP, just as what the President of the United States, the Secretary of State, and the U.S. Trade Representative announced in public, is merely for the recession-racked United States to ‘tap into’ the market of an increasingly prosperous Asia–Pacific region.”<sup>7</sup>

According to empirical research done by some Chinese scholars, if the TPP is successfully negotiated and implemented, it might have some overall positive economic impact for the U.S. economy. However, the direct economic benefit

brought by TPP could be marginal, particularly in the short run.<sup>8</sup> This makes some academics believe the real U.S. intention is to gain indirect long-term economic benefits, including strengthening the trade relationship between the Asia–Pacific region and the United States, helping American enterprises enjoy an enabling FTA environment, and ensuring the United States' status as the rule-maker in regional trade regulations.<sup>9</sup>

Although U.S. officials insist that their interest in TPP is mainly for economic purposes, still other Chinese scholars are quite skeptical. These scholars argue that the United States' major incentive, like its FTAs established with other countries in history, is not economic but geopolitical. They note several trends. First, China should analyze U.S. motives from a strategic perspective, relating TPP to the recent U.S. pivot to Asia. Fu Mengzi, vice-president of the China Institute of Contemporary International Relations (CICIR), states that “TPP reflects the fact that the United States is taking a substantive step on its strategy of returning to the Asia–Pacific region.”<sup>10</sup>

Second, Li Xiangyang, Director of the Institute of Asia–Pacific Studies under the Chinese Academy of Social Sciences (CASS), contends that Sino-American competition should be considered an important element when analyzing TPP, and that the United States' main political objective in joining is to contain China's rise in East Asia.<sup>11</sup> Similarly, Yang Jiemian, president of the Shanghai Institute of International Studies, suggests that the United States strategy “dilutes” and “reduces” China's influence in the Asia–Pacific region, something that could be considered a “soft confrontation.”<sup>12</sup> In an article published in *People's Daily*, an official newspaper of the Communist Party, journalist Ding Gang states that “the United States does not want to be squeezed out of the Asia–Pacific region by China . . . TPP is superficially an economic agreement, but contains an obvious political purpose to constrain China's rise.”<sup>13</sup>

Third, some scholars argue that the United States' real intention is to interfere with East Asia's regional economic integration, gaining the upper hand over China and becoming the dominant economic power of the region. People from both an economics background and an international relations background favor this argument.<sup>14</sup>

Previously, most East Asian cooperative programs did not include the United States. The region's current economic integration contains a “10+3” framework that includes ASEAN, the mainland of the People's Republic of China, India, Japan, and South Korea. This leaves the United States without an active seat at the table, which renders the economic ties between the United States and East Asia weaker.

In order to strengthen its economic ties with East Asia, the United States once actively pushed for the movement of the Asia–Pacific Economic Cooperation (APEC) framework and hoped that APEC talks could eventually

evolve into forming an agreement to establish a Free Trade Area of the Asia Pacific (FTAAP). However, it turns out that this idea did not work, and APEC has gradually devolved into a nominal multilateral communication platform of trade ministers of the Asian–Pacific countries.

With its declining regional influence, the United States faces the possibility of being marginalized. Hence, according to some scholars, the United States joined TPP to co-opt the East Asian economic cooperation process and renew its collaboration with the Asia–Pacific region. Some go further, asserting that the United States not only wants to contain China, but dissolve East Asian regional economic cooperation as a whole, paving the way for the United States to claim dominance over the entire East Asia region.<sup>15</sup>

#### **TPP's effect on China**

Judging from TPP's theoretical influence over China, most Chinese scholars claim its successful implementation will have a negative impact on China. This negative impact includes “trade diversion,” when an FTA diverts trade from a more efficient exporter towards a less efficient one. Since some of

the TPP-member countries are developing countries, their exports are similar to China's, but their prices are lower. This triggers export competition between China and these developing countries. Under such circumstances, TPP will pose a severe threat to China's exports to the United States.<sup>16</sup> This threat increases if Japan joins negotiations, because Japan has a huge overall volume of trade and an

already competitive trade relationship with China. Japan's joining makes the TPP even more dangerous for China's economic interests.

The TPP may also threaten China's geopolitical status in the long term. For instance, Shen Minghui, a research fellow at CASS, notes that implementation of the TPP would attract ASEAN countries and other U.S. allies in East Asia to adopt a pro-U.S. policy, one that supports its return to East Asia, which would in turn estrange China from those countries. This would present a huge threat to China's strategy and status in the East Asia region. China should pay attention to TPP's tentative geopolitical implications, Shen warns, and respond to them strategically.<sup>17</sup>

Other Chinese scholars, however, believe China doesn't need to worry about the potential damage brought by TPP. For instance, Huang Renwei, Vice President of SASS, and Zhu Feng, a professor at Peking University, point out that TPP will have little impact on China because countries in the Asia–Pacific

**Japan's joining makes the TPP even more dangerous for China's economic interests.**

region rely on China economically. Thus, they cannot afford to lose China's valuable trade. Furthermore, if China could actually promote its own economic cooperation mechanisms in East Asia, such as the 10 + 3 framework, regional economic development would proceed continuously and offset the actual sway of TPP. Therefore, China should just continue to build self-confidence, which is necessary to its own long-term economic development.<sup>18</sup>

The analysis above is mainly based on the assumption that TPP could be successfully negotiated and implemented. Some Chinese scholars, however, predict that it will not, and that therefore China does not need to concern itself with TPP right now. Mei Xinyu, researcher at the Chinese Academy of International Trade and Economic Cooperation in the Ministry of Commerce, argues both that the high standards TPP pursues and the different economic development stages of the participating countries will make implementation difficult.<sup>19</sup> Sheng Bin, an economics professor from Nankai University, also argues that the cleavage in U.S. domestic politics (such as those between Congress and the president, between the two parties, and resistance from U.S. domestic interest groups) are all vital factors constraining successful TPP negotiation.<sup>20</sup>

Furthermore, some Chinese scholars relate TPP with the coming U.S. presidential election. Yuan Peng, Director of the Institute of America Studies at CICIR, argues that incumbent U.S. President Barack Obama has used TPP to boost his presidential campaign for the next term, as well as a tactic to strive for more votes. But who knows if the American president, or even the American public, will support TPP after the election?<sup>21</sup>

## China's own FTA Agenda

Taken aback by the United States' recent support of TPP, the Chinese government is now trying to figure out how to best counter-balance the growing U.S. economic influence in East Asia. According to a research fellow from CASS, the most important strategy for the Chinese government at this point is to actively push for its own FTA strategy.<sup>22</sup> Li Wei, President of the Development Research Center of the State Council, said in a keynote speech on the Asian Financial Forum that the Chinese government's "unswerving policy" is to accelerate the development of free trade areas with China's major trading partners in Asia. While he noted that some Asian countries are currently trying to cooperate with economies outside the Asian region to establish a wider range of inter-regional free

**The most important strategy for China is to actively push its own FTAs.**

trade relations, Li also cited an old Chinese proverb: “close neighbors are better than distant relatives.” He advised that the close geographical location between Asian countries is “a vital guarantee for each other’s economic stability and development,” and “cooperating with countries far away might not be beneficial for these countries’ own economic development.”<sup>23</sup> He Liangliang, a commentator from Hong Kong, suggests that Li’s speech likely points to Japan’s recent policy shift of expressing interest in TPP. According to him, the speech is a clear indicator that China will actively propel the establishment of new FTAs with more of its Asian neighbors to counter-balance the TPP agenda pushed by the United States.<sup>24</sup>

The U.S. interest in TPP and its subsequent regional encroachment has spurred Beijing to increase its pace on pushing FTAs. China wants to demonstrate to its neighbors that it will continue to be a reliable bilateral economic partner. As of early 2012, China has signed bilateral and multilateral FTAs with ten countries/regions: Hong Kong, Macau, Taiwan, ASEAN10, Pakistan, Chile, New Zealand, Singapore, Peru, and Costa Rica. It is also in the process of signing bilateral FTAs with several others like Australia, Iceland, South Korea, Norway, Switzerland, the Gulf Cooperation Council (GCC), and the Southern African Customs Union (SACU).<sup>25</sup> Most recently, after seven years of preliminary talks, Chinese Commerce Minister Chen Deming and South Korean Trade Minister Bark Tae Ho announced on May 2nd, 2012, the start of the formal negotiations for the Sino-Korea FTA.<sup>26</sup> At the end of May, the trade ministers of South Korea, Japan, and China, for the first time in history, agreed to launch negotiations for a trilateral FTA by the end of this year.<sup>27</sup>

The Chinese government is not driven primarily by economic concerns when pushing its FTA agenda; political factors play just as important a role. Beijing wants to improve its relationship with its neighbors. Though the Chinese Government has persistently portrayed itself as “rising peacefully,” not all of its neighbors have been charmed. For example, Beijing’s rise as a regional and global power has aroused both economic and strategic fears among its ASEAN neighbors, to varying degrees.<sup>28</sup> Some of these fears stem from an historic mistrust, and have been exacerbated by recent tensions in the South China Sea.

The Chinese government has long been trying to diminish mistrust like this, and to build closer political ties with most of its neighbors by offering them economic benefits through FTAs. For instance, China’s FTA with Taiwan serves as an effective tool to enhance the formation of a “one China” political identity and suppress separate independence movements. China’s intention to negotiate a bilateral FTA with Australia also could be viewed from a political lens: China

views Australia as an important country in the South Pacific and feels that Sino–Australian bilateral relations are not close enough, which may reflect its concern with Australia's strategic alliance with the United States and Japan.<sup>29</sup> Beijing hoped the FTA would be a useful instrument to strengthen the strategic relationship with Canberra, upgrading it from “friendly cooperation” to a “strategic partnership.”<sup>30</sup>

China's FTA strategy also considers joining TPP. Becoming a member of TPP could be beneficial to China in three ways: First, if China joins TPP in its early stages, China would be able to bargain with the United States at the outset and might be able to exert influence over the rule-making of the TPP, which could therefore safeguard China's own interests.<sup>31</sup> Second, China joining would further facilitate the regional trade liberalization process in the Asia–Pacific region, especially important since the Doha Round went into a stalemate. Finally, joining the TPP would propel China to improve its labor and environmental standards under external pressures, which will be beneficial to China's long-term economic development.<sup>32</sup>

**China is also considering joining TPP, although it is still cautious about this option.**

Despite the potential benefits of joining the TPP, China is still cautious about this option. Under the current TPP framework, if China would like to join, it must acquire approval from all the current TPP member countries, which is obviously not easy. China might have to make big concessions. Hence, Chinese Commerce Minister Chen Deming stated that China will evaluate the possibility of joining TPP, but also wants the process to be open, inclusive and transparent.<sup>33</sup>

Apart from pushing its own FTA agenda, China is also leveraging its monetary resources through different channels to attract ASEAN nations. In November 2011, Premier Wen Jiabao offered ASEAN nations a generous package ranging from \$10 billion worth of credit to pledges for more technology exchanges, while reminding the region that ASEAN–China trade would hit \$400 billion by the end of that month. Premier Wen also announced a new \$3 billion maritime cooperation fund, aimed at deflecting concerns by the Philippines and Vietnam that Chinese claims in the South China Sea might impede freedom and safety of navigation in the area. Zhao Kejin, an international relations professor at Tsinghua University, notes that Beijing's strategy is to remind Asia that “integrating with China will yield benefits” that the region cannot get from allying with an economically weak United States.<sup>34</sup>



## The Effectiveness of China's FTA Strategy

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Though the Beijing leadership is actively pursuing its own FTA agenda as a strategy to counter-balance the TPP agenda, it is highly unlikely that such a strategy will help China fulfill its goal of improving its neighboring environment. According to Harvard professor Joseph S. Nye, China's growing economic and military might has frightened its neighbors into looking for allies to balance China's increase in hard power.<sup>35</sup> Although the Chinese government is trying to "bribe" its Asian neighbors with economic benefits, China's amiable stance has constantly been undercut by its unwillingness to solve territorial disputes in a multilateral setting, as well as its simultaneous threat to browbeat its neighbors.

For instance, in 2010, China's rapidly increasing military budget and naval modernization spooked its ASEAN neighbors—especially in view of the territorial disputes in the South China Sea concerning the resource-rich Spratly and Paracel Islands. Concern about China's military ambitions led neighboring ASEAN countries, particularly Vietnam, to try to internationalize the dispute. Comments by U.S. Secretary of State Hillary Clinton in 2010, indicating that "the United States would be willing to facilitate multilateral talks on the issue," elicited a furious response from Beijing, which charged that the United States was interfering in the issue.<sup>36</sup> Tensions in the South China rose again recently between China and the Philippines: in May 2012, Chinese state media warned the Philippines of potential military conflict over the Scarborough Shoal, a disputed reef off the Philippine coast.<sup>37</sup>

Furthermore, while China has been actively pushing for the China–Japan–South Korea trilateral FTA talks, recent developments in May

of this year have demonstrated once again that domestic affairs appear to carry more weight for the three national leaders than regional economic projects.<sup>38</sup> On May 13th, 2012, Chinese Premier Wen Jiabao met with South Korean President Lee Myung-bak and Japanese Prime Minister Yoshihiko Noda in Beijing for the annual China–Japan–South Korea trilateral summit talks.<sup>39</sup> However, after the summit, Chinese president Hu Jintao refused

without explanation to meet with Prime Minister Noda. Speculators have suggested that Hu's cancellation might have been triggered by the heated debate on May 13 between China and Japan over the sovereignty of the disputed Diaoyu/Senkaku Islands, or perhaps by Japan's granting a visa to Uighur leader Rebiya Kadeer to run the World Uyghur Congress in Tokyo.<sup>40</sup> More broadly,

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long-lasting territorial disputes and historical tensions between China and both of these neighbors complicate the task of rebuilding mutual trust. Given this backdrop it will be difficult, if not impossible, for China's FTA strategy to reach its political aim.

China's domestic political environment further undermines the effectiveness of China's FTA strategy. The Chinese Ministry of Commerce is the central government agency leading China's FTA negotiations. Inside the Ministry, the Office of the Representative for International Trade Negotiation is responsible for the actual implementation of FTA negotiations. However, since FTA negotiations involve the tentative elimination of trade barriers, the Ministry of Commerce also needs to consider the vested interests of other Ministries such as the Ministry of Industry and Information Technology (responsible for regulating and developing the Internet, the software industry, and production of electronic and information goods) or the Ministry of Agriculture. Under these circumstances, two Chinese Vice Premiers, Wang Qishan, who monitors finance and trade, and Zhang Dejiang, responsible for industry and energy, must balance different interests among ministries and facilitate successful implementation of FTA negotiations. However, since different ministries represent the interests of different industries in China and thus usually push for different policy agendas, even with the coordination of Wang and Zhang, the inter-ministry coordinating mechanism is still inherently ineffective.

Furthermore, even though it is the lead agency to negotiate FTAs, the Chinese Ministry of Commerce does not possess the formal authority to settle conflicts among domestic interests. Moreover, there has yet to be a "Central Leading Group," or coordinating mechanism, made of a Premier and ministerial-level representatives to negotiate different interests among ministries.<sup>41</sup> Hence, each Chinese Ministry tends to pursue its own vested interests in the negotiations, which means the Chinese government usually lacks a unified position in FTA negotiations.

Complicating matters further, Chairmen of large SOEs often outrank the Ministry of Commerce: the Organization Department of the Communist Party of China Central Committee appoints the Chairmen, and this Committee has greater political power than the Ministry of Commerce.<sup>42</sup> Thus, Chairmen often choose to directly lobby other powerful Ministries to exert pressure over FTA negotiations. In July 2004, for instance, China and the GCC signed a Framework Agreement on Economic, Trade, Investment and Technological Cooperation, which established discussions for a China–GCC free-trade area.<sup>43</sup> However, the negotiation eventually stalled due to strong domestic resistance from China's state-owned oil giants, who would suffer huge losses if China were to reduce tariff barriers on energy products imported from GCC countries.<sup>44</sup> Similarly, China's

state-owned automobile enterprises regard the China–South Korea FTA negotiations as a potential threat to China’s domestic auto industry.

In many circumstances, the Chairmen of these large SOEs had considerable domestic power before becoming involved in politics. For example, Miao Wei, the current Minister of Industry and Information Technology, was once the General Manager of Dongfeng Automobile Corporation, a leading state-owned automobile company. Similarly, Su Shulin, the current Governor of China’s Fujian Province, was once the Chairman of Sinopec Corporation, a leading state-owned oil giant. This contributes even further to giving China’s SOEs a disproportionately strong voice in FTA negotiations.

Hence, domestic interests have constrained Chinese FTA negotiators’ room for concession not only because of their assertiveness, but also because of the features of China’s policymaking institutions.<sup>45</sup>

## Conclusion

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From China’s perspective, the TPP framework is a crucial component of the U.S.’s recent policy initiative of “returning to Asia,” which poses a challenge for China both economically and geopolitically. To counter-balance the U.S. initiative, China is actively pushing for its own FTA agenda, in particular trying to move forward on the China–Korea and China–Japan–South Korea FTA negotiations, ultimately seeking to construct a regional web of its own free trade agreements.

Yet, just as the United States has domestic interests that may impede TPP negotiations, China’s rising domestic interests will increasingly complicate its own ability to see its FTA strategies through to fruition. Large Chinese SOEs, which are afraid of their vested interests being damaged and who possess a disproportionately strong lobbying power over the central leadership, and the cleavage of interests among different Chinese ministries would both constrain the Chinese government’s ability to move forward on its FTA agenda.

China’s domestic and strategic considerations make its FTA agenda difficult to predict, but it is worth pointing out that China has not closed its doors towards the possibility of joining TPP itself. If the Chinese government feels that the benefits of joining outweigh the costs, then China may indeed apply.

## Notes

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