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**China's Competitive FTA Strategy:  
Realism in a Liberal Slide**

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Compared with Europe and North America, East Asia is a late comer in regional economic cooperation and China is one of the latest in the region. In May 2001, China became a member of the Bangkok Agreement, the first free trade area analogue the country joined. China has moved fast since then. It has (partially) completed free trade agreement (FTA) talks with the 10-member South East Asia Nations (ASEAN), Chile, Pakistan, and New Zealand and has signed a Closer Economic Partnership Agreement (CEPA) with Hong Kong and Macau. Beijing is also in FTA talks with Australia, Iceland, Gulf Cooperation Council (GCC),<sup>1</sup> Singapore and lately Peru. It has completed or started joint feasibility research for FTAs with a number of countries, including the Southern African Customs Union (SACU),<sup>2</sup> India, Japan, South Korea and Switzerland (see Table 1 on page 26).

This paper investigates the driving forces for China's FTA offensive. It first briefly discusses the role of Chinese think tanks in China's foreign policymaking, followed by an investigation of China's interest in FTAs, focusing on Beijing's genuine interest in liberal free trade and its pursuit for realist relative gains. The paper then examines China's four FTA partners, namely Pakistan, ASEAN, Chile and New Zealand.

### **Chinese Think Tanks**

This paper is largely based on Chinese publications. It is therefore necessary to briefly discuss the actors in China's foreign policymaking. Bin Yu noted in 1994 that

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<sup>1</sup> The member states of the GCC include Saudi Arabia, Oman, the United Arab Emirates, Kuwait, Qatar and Bahrain.

<sup>2</sup> South Africa announced in June 2004 that the SACU would start FTA negotiations with China. No progress has been reported however. The SACU consists of five Member States, Botswana, Lesotho, Namibia, South Africa and Swaziland.

although more think-tank and civil society actors had become involved in China's foreign policymaking since the 1980s, the role of the officials of the Ministry of Foreign Affairs remained central. He suggested that China's official foreign policy makers tended to distrust scholarly writing on foreign policy (Yu, Bin 1994: 254). However, that observation is out of date. While a gap does exist between specialists and policy makers, it is narrowing as a more pragmatic Chinese foreign policy and a more bureaucratic policymaking process evolves. Glaser and Saunders (2002: 597) argue that "a more pluralistic and competitive policy environment has given analysts at think tanks more influence." Lampton also notes that the complexity of foreign policy issues has resulted in the professionalization of China's foreign policymaking, which has given Chinese analysts the opportunity to make significant inputs. Lampton (2001: 8-10) emphasizes that "in the economic arena ... the need for specialized research has become increasingly pronounced," and there is a "growing reliance on internal and external research."

According to Shambaugh (2002: 575-576, 581), "undoubtedly the decision-making system has become more consultative over time, with an increased role played by the think tank specialists", so much so that "today they must be considered important actors in the foreign policy making process in the PRC." To Shambaugh (2002: 581), the published journals of Chinese foreign policy think tanks "provide very important insights into policy debates that are percolating inside bureaucracies, thus offering important 'early warning indicators' of policies to come." Tanner (2002: 559) also emphasizes that Chinese think tanks are now "some of the most important windows through which foreign analysts can observe China's usually opaque policy-making system."

While it is widely accepted that Chinese think tanks and analysts can influence China's foreign policymaking, it is difficult to assess the actual influence which varies dramatically and depends on a number of factors. Glaser and Saunders (2002: 608-613) have classified four types of influence: expertise influence based on where an analyst works in the bureaucracy, expertise influence based on the analyst's expert knowledge, personal influence based on the analyst's personal connections with policy makers and experiential influence based on the analyst's career history and personal experience.

Along with the growing influence of Chinese think tanks and analysts, public opinion is emerging as a factor which cannot be ignored. Lampton (2001: 12) regards the increased influence of public opinion in Chinese foreign policymaking as a good example of "corporate pluralization", which refers to "the proliferation of organizations, groups and sometimes individuals in the policy-making process."

It has long been a challenge to assess the role of public opinion in foreign policymaking. Rosenau (1961: 4) noted in 1961 that "we have little reliable knowledge about the role of public opinion in shaping foreign policy." Understandably, it is far more difficult to specify the role of public opinion in an undemocratic country like China. Nevertheless, Fewsmith and Rosen (2001: 186) concluded in 2001 that "public opinion seems destined to play a more important . . . role in Chinese foreign policy in the future." Lampton (2001: 12) is more specific, saying that "some issues and some domestic circumstances allow the leadership less room to operate than others. Leaders understand which issues are so sensitive that to mishandle them could lead to social instability or could provide political competitors an avenue by which to undermine them." Although the issue of FTA can have strong domestic implications, it is not a sensitive issue to the

Chinese public. The Chinese public is not well informed and therefore can offer little input to China's FTA negotiations. The Chinese business, however, does play a role by participating in the feasibility studies and the subsequent negotiations.

### **A slide towards liberalism**

Since 1978 when China opened up, Beijing has made a consistent effort to integrate with the international society. One indication is its support for the United Nations and various international regimes. In the 29 years from 1949 when the People's Republic China (PRC) was established to 1977, China was a party to a total of 31 international treaties. In contrast, in the 27 years from 1978 when China opened up to the end of 2004, China signed 236 international treaties (Rao 2005: 51).

China's effort to integrate with the international society is a process of learning and accepting liberal norms which were foreign to the Chinese whose world views had been dominated by Marxism-Leninism and a sense of insecurity derived from China's "Century of Humiliation" (1840-1945) when China suffered at the hands of foreign invaders. Since 1978, China has been exposed to Western liberal norms. The end of the Cold War accelerated China's slide towards liberalism. Medeiros and Fravel (2003: 23) noted in 2003 that "in the last ten years, Chinese foreign policy has become far more nimble and engaging than at any other time in the history of the People's Republic." Evidence of these changes include the expanded number and depth of China's bilateral relationships, new trade and security accords, deepened participation in key multilateral organisations, widening acceptance of many prevailing international rules and institutions and efforts to help address global security issues.

China's slide towards liberalism is most noticeable in the economic area, highlighted by its 15-year request to join the World Trade Organization (WTO) from 1986 to 2001. And China's trade liberalization has been rewarding. Since it started economic reforms in 1978, China has pursued a development strategy of export-led growth. After three decades of economic reforms, the Chinese economy has been transformed from a closed socialist command economy into an open, trade-oriented capitalist economy. From 1978 to 2006, China's trade volume grew more than 85 times from U.S.\$20.6 billion to U.S.\$1760.4 billion (Ministry of Foreign Trade and Economic Cooperation, China; National Bureau of Statistics of China, 2007: 730). China is now one of the countries most dependent on foreign trade. According to Chinese statistics, 70 percent of China's GDP was generated by merchandise trade in 2004 (Zhang, Huang et. al. 2006: 42; Chen, Taifeng 2005: 62).<sup>3</sup> In the same year, the figures for the United States and Japan were 25 percent and 26 percent respectively (Xiao and Du, 2007: 2).

Having benefited from free trade, most Chinese economists have been supportive of global trade liberalization and believe that China should not stop its liberalization process. They often point to the successful examples of free trade and the unsuccessful cases of either protectionism or economic nationalism. One unsuccessful case is Latin America. It is noted that during the 1960s and 1970s, under the influence of economic nationalism, many Latin American countries changed their free trade policy and became more protectionist, which resulted in the unsatisfactory economic performance of these countries since the 1980s (Jiang 2007: 20).

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<sup>3</sup> China's statistics are questionable in that China's real GDP can be underestimated as much of the output generated by the tertiary industry is not included. China's unusually high dependency on trade is also due to its high percentage of processing trade (Han et. al. 2006: 16).

Chinese analysts (Jiang, 2007: 20-21; Zhang, Zhen 2004: 4-6) have listed a number of benefits that FTAs could generate, including

- the effect of economy of scale
- improvement of the structure of the market through an intensified competition
- stimulating foreign investment
- protecting the continuation of economic reforms through binding agreements
- attracting potential investors by signaling the government's trade policy and good relations with FTA partners
- creating an insurance mechanism by preventing protectionism
- strengthening the bargaining power of FTA partners against a third party
- improvement of the coordination among different economic sectors by mobilizing free trade agreement supporters
- contributing to the settlement of international disputes in security areas

Having noted the slow progress and its limited influence in multilateral talks, China has become increasingly interested in the potential for regional trade liberalization, an arena in which it could play a stronger and more effective role (Wang, Qin 2005: 59).

China's FTA offensive also reflects Beijing's effort to learn the international economic game and to emulate other countries. The Chinese started their economic reforms with little experience and had to, as Deng Xiaoping said famously, "cross the river by feeling the stones". Although Beijing soon accepted the concept of free trade, it still is playing the catch-up game.

China's FTA policy shift therefore can be a process of learning and emulation. FTA strategies of the United States and Europe have been particularly influential to China's FTA policy (Zheng, Xianwu 2003: 5-6). In Northeast Asia, Chinese observers have noted a trend of moving away from the Asia-Pacific Economic Cooperation (APEC)

and towards FTAs since the 1997-98 Asian Financial Crisis (Zhang, Zhen 2004: 2; Zheng, Xianwu 2002: 30-31).

China's emulation process is marked with both caution and ambition. On the one hand, China started its FTA negotiations with relatively liberal and small economies. On the other hand, China's FTA offensive is global, with negotiation partners in Latin America, Oceania, South and East Asia, the Middle East, Europe and Africa. Chinese analysts term these partners as China's front posts (*qianzhan*) in China's global FTA strategy (Zheng and Yu 2006: 7).

To summarise, we may argue that China is interested in liberal absolute gains derived from FTAs. After all, China is deeply involved in global trade and has been its major beneficiary.

### **Realist Calculations**

While China has been on a liberal slide, realism continues to determine Chinese foreign policy. Deng (1998: 320) observed that despite the growing *idealpolitik*, the dominant thinking of international relations among Chinese analysts was still realist. Lampton (2001: 24-25) also noted that "although there is plenty of evidence of increasing Chinese cooperation and conformity with international norms, there is little evidence that considerations of national interest and *realpolitik* figure any less prominently in Chinese thinking than they always have."

In terms of China's FTA strategy, while the liberal absolute gain has laid a foundation, the selection of FTA partners and the speed and urgency of FTA negotiations are often determined by China's effort to compete for realist relative gains. Zhang



Anyuan (2006: 7) warns that compared with the WTO, FTAs cover a broader area and are more discriminative against non-partners. Zhang also notes that even the FTAs that do not seem related to China could have a strong impact on China. Chinese analysts advise Beijing to follow the trend and to join the “small group” of FTAs after joining the “big group” of the WTO in order to avoid being marginalized (Zhang, Fan 2004: 75). “Everyone is talking about FTAs. Everyone is conducting FTA talks. Especially after the Doha negotiations reached a deadlock, the FTA talks concerning China and nations worldwide reached their highest peak,” noted a senior researcher at the Institute of Asia-Pacific Studies at the Chinese Academy of Social Sciences (“China-Pakistan FTA to promote bilateral trade” 2006). The following paragraphs investigate China’s competitive FTA strategy, focusing on the economic, political and legal aspects.

### *Economic competition*

It is generally believed that China’s rapid growth of exports is to a great extent due to its cheap labor, raw material and land. China’s labor cost in 2003 was just one fiftieth of that in the United States and Japan. However, China’s advantage of cheap labor is offset by its low productivity which was only one twenty-fifth of that of the United States and one twenty-sixth of Japan’s (Zhang, Huang et. al.2003: 122). Meanwhile, the costs of labor, raw material and land all have been increasing. It was observed in 2004 that already some leveling of wages was taking place between Hong Kong and Shanghai (Ariff 2003). It is thus imperative for Chinese producers to continue to reduce the costs so that their products stay competitive in the world market. FTAs are most effective in lowering tariffs and thus substantially reducing the costs of both exports and imports. FTAs could

also save costs by enhancing the efficiency and productivity of China's somewhat old-fashioned command enterprises, partly due to the effect of scale and because rationalization and modernization would be stimulated by the new competition (Bi 2005: 15).

China also attempts to use FTAs to make good use of rules of origin (ROOs) and to deal with possible negative impacts derived from ROOs in various FTAs. FTAs are effective in addressing China's ROOs concerns not only because China can negotiate ROOs to its benefit but also because FTAs will facilitate Beijing's "go out" (*zou chu qu*) strategy which pushes its enterprises to go global. This is in line with Beijing's interest in the WTO membership. As a member of the WTO, China would have to further open up to international trade and investment, which "would prod necessary reforms of domestic enterprises by subjecting them to competition from—and transformative partnerships with—foreign firms" (deLisle 2006).

Related to its ROOs concerns are Beijing's efforts to reduce the impact of trade diversion resulted from competing FTAs. The South Korea-U.S. FTA, which was signed on April 2, 2007, alarmed the Chinese to a considerable extent. In addition to the strategic implications of U.S. strategic counter balance against China (Caryl 2007; Kim 2007), competitive U.S. agricultural products could threaten Chinese agricultural exports to South Korea. With an annual value of about U.S.\$3 billion, South Korea is the second biggest market for Chinese agricultural exports after Japan (Song 2007: 39). On the other hand, American businesses have expressed intention to reduce their imports of textiles and apparel from China and use South Korea as a replacement ("South Korea: US buyers keen to source more apparel, textiles" 2007).

A more immediate effect of FTAs is that they help to address China's concerns about the anti-dumping (AD) charges against Chinese exporters. Since its accession into the WTO in late 2001, China has faced an increasing number of AD investigations, to the extent that it appears to be the number one victim of AD investigations.<sup>4</sup> From 1995-2006, China faced 536 AD investigations, 2.34 times of South Korea's 229 which was in the second place. In terms of final AD measures during this period, 375 were directed at China, 2.76 times of South Korea's 136 (World Trade Organization 2007a). One major reason for the large number of AD charges against China has been that many countries do not recognize China as a market economy. All WTO members have 15 years to recognize China's market economy status after China's entry into the WTO in 2001. China's FTA efforts could have some immediate impact on reducing the number of AD investigations against China as a number of the countries which have launched AD investigations against China are China's FTA partners or negotiation partners, such as Australia, New Zealand, Pakistan, Chile, Indonesia, Philippines and Malaysia. China has also completed the China-India FTA feasibility study and is looking into the feasibility of negotiating an FTA with South Korea. Both India and South Korea are active AD players (World Trade Organization. 2007a).

### *Political competition*

While economic competition is an apparent factor in China's interest in FTAs, political competition is no less important. In analyzing U.S. FTAs, deLisle (2006) notes that

FTAs can serve as an economic instrument in the pursuit of security goals that loom large in U.S. foreign policy. . . More crassly instrumentally, they

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<sup>4</sup> Although China is subject to more AD initiations and measures than any other countries, it is not the biggest victim in terms of intensity relative to trade value.

can serve as economic goodies that Washington can dole out to serve political ends of building or reinforcing alliance-like arrangements.

A similar observation can be applied to China. deLisle (2006) actually points out that “compared to the U.S., the political dimension is even larger for Beijing and the commitment to the relatively radical economic liberalism ideals behind FTAs (or of the broader international trade regime) less established and robust.”

Chinese analysts emphasize that China’s FTA strategy should help China “enhance its influence in the international political economy and expand its political and security space” (Zhang, Fan 2004: 75). Therefore, China should make FTAs “an important tool for both economic diplomacy and political diplomacy” (Liu, Changli, 2005: 10). Thus, Chinese analysts are wary of Japan’s effort to negotiate FTAs or EPAs (Economic Partnership Agreements) with China’s neighbors. They deem it imperative for China to “break up the encirclement of Japan’s FTA strategy” (Liu, Changli 2005: 10). The reason seems simple—the countries with closer economic relations with Japan will inevitably improve their political relations with Tokyo, which may dilute China’s regional leadership potential.

Another political and strategic consideration in China’s FTA strategy is Beijing’s effort to establish a long-term, reliable supply of overseas resources and energy. According to the Development Research Centre of the State Council of China (2005), in the years before 2020, China is expected to experience rapid industrialization and China’s demand for resources will peak (see Table 2). In 2003, the percentages of China’s consumption of petrol, lead, copper, nickel, steel, coal and cement in world total were 7, 19, 20, 21, 25, 30 and 50 percent respectively. China’s steel demand outstripped the

demand in the United States and Japan combined, and the Chinese demand for copper, nickel, zinc, iron ore and cement also surpassed the United States. On the other hand, China's per capita possession of resources is far below world average. Its per capita mineral occupation is about a half of the world average, per capita arable land area and per capita water resources about one third of the world average, per capita forest area only one sixth of the world average, and per capita coal, oil and gas about three fifths, one tenth and one twentieth of the world average respectively.

**Table 2.** China's Increasing Dependency on Imports of Key Minerals

Mineral	Dependency on imports (%)		
	2000	2010	2020
Petroleum	31	41	58
Iron Ore	33	34	52
Manganese	16	31	38
Copper	48	72	82
Lead	0	45	52
Zinc	0	53	69

Source: Development Research Centre of the State Council 2005.

### *Legal competition*

Related to economic and political competition is legal competition. The three can hardly be separated. A Chinese analyst argues that for great powers, to play a leading role in regional economic cooperation is not just for their interests in the region or internal benefits (*neibu shouyi*). More importantly, the great powers are aiming at the external benefits (*waibu shouyi*), namely to increase their bargaining chips in multilateral negotiations and further to play a leading role in the making of international economic rules (Zhang, Zhen 2004: 5). While having benefited from its active participation in global trade and investment, Beijing has long believed that the existing international economic order is a part of the "unfair and irrational" international order. Beijing's "fair and rational" international order is based on its vision for a "harmonious world". Chinese

President Hu Jintao elaborated the concept of harmonious world by raising some specific suggestions. Economically, Hu urged the international society to actively push forward the establishment of an open, fair and indiscriminative multilateral trade mechanism, further improve the international financial system, reinforce global energy dialogue and cooperation and jointly maintain energy security and the stability of the energy market (Ministry of Foreign Affairs, China 2005; Wang, Gonglong 2007: 56-62).

China clearly is interested in making changes to the existing international trading system to ensure a “fair and rational” international economic order. Chinese officials have repeatedly pointed out that the WTO decision-making process is dominated by a few states and the views of developing countries are not adequately considered. For instance, as a developing country, China opposes any linkage between trade and labor standards and “the use of environmental standards as a new form of protectionism” (Lardy 2002: 156). One of China’s goals in participating in globalization and joining international economic institutions is to shape the rules of the international trading system (Zhang, Huang et. al. 2004: 12). It is believed that those who set the international rules have vested interests and they have no intention to let China enjoy the benefits automatically (Liu and Gong 2007: 18). “An unchangeable rule (*tie de faze*) is that those who set rules will benefit from the rules”, Chinese analysts emphasize (Han et. al. 2005: 7).

China’s perceptions of U.S. and EU policies towards China’s market economy status highlight its dissatisfaction with some of the existing international trading rules. While acknowledging that China still needs to continue to marketize its economy, Chinese analysts do not see it a purely economic issue, especially vis-à-vis China’s major

trading partners. It was noted that early in 2001 the market economy in China surpassed world-recognized threshold of 60 percent and made up 69 percent of the Chinese economy. China thus was well ahead of Russia in terms of economic liberalization (Chen, Taifeng 2005: 184).<sup>5</sup> Yet the United States recognized Russia's market economy status in June 2002 and the EU followed in July 2002. Chinese analysts believe that a key reason why Washington recognized the market economy status of former socialist countries like Russia, Romania and Bulgaria but not China's is that these countries had changed politically and had moved closer to the United States in their foreign policies (Chen, Taifeng 2005: 188).

It is no surprise that one of China's goals in multilateral trade talks is to establish uniform (*tongyi*) market economy criteria (Zhang, Huang et. al. 2005: 107). Given China's limited influence in international economic institutions, Beijing is unlikely to achieve the goal in the near future. A "more feasible" approach is to enlist as many countries as possible to recognize China's market economy status, which China hopes will impose pressure upon other countries to follow the suit (Zhang, Huang et. al. 2005: 107). New Zealand was the first developed country to recognize China's market economy status and was rewarded as the first developed country to start FTA negotiations with China. By October 2007, 76 countries had recognized China's market economy status (Bhuyan 2007).

China is not actively challenging the existing international trading system however. This is partly because China is still learning how to play the international economic game. deLisle (2006) notes that "China has remained largely a 'regime taker'—accepting the existing rules . . . and pledging to abide by them." It is unlikely that

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<sup>5</sup> For a more comprehensive assessment of China's marketization, see Li, Xiaoxi (2006).

we will see a dramatic change in the near future. While suggesting that China should not accept the unfair requirements forced upon China (Zhang, Huang et. al. 2003: 221), Chinese analysts have observed that

China's strategy of actively participating in economic globalization demonstrates that in the process of turning China into a world-class economic power, China accepts the existing international economic order instead of challenging it. Not only does China not challenge this order, it utilizes the order. China will first accept the existing international economic order and then work with other countries, especially the developing countries, to gradually improve it (Zhang, Huang et. al. 2004: 12).

China's UN experience shows that it prefers integration first and gradual changes second. When the PRC was admitted to the United Nations in late 1971, there were concerns that Beijing would disrupt the status quo and would use its veto power to paralyze the UN Security Council. But as Samuel Kim has noted, within the UN, China is "a satisfied conservative system maintainer, not a liberal system reformer nor a revolutionary system transformer" (as cited in Lardy 2002: 155).

Legal competition is thus not a major factor driving China's FTA negotiations. However, with a rapidly growing economy, it may not be long before China starts to leave its mark on the rules of the international trading system. International order evolves with the rise and fall of great powers. As Drezner (2007: 39-42) points out, global institutions cease to be appropriate when the allocation of decision-making authority within them no longer corresponds to the distribution of power. A good example is the G-7. The G-7 was moderately successful in managing global macroeconomic imbalances during the 1980s. Today, these economic giants cannot be effective without including in their deliberations economic heavyweight China. Drezner argues that despite the widely shared perception of U.S. unilateralism, the George W. Bush administration has actually



made a consistent effort to incorporate emerging powers while placating status quo states. For instance, the United States has encouraged China to participate periodically in the G-7 meetings of finance ministers and central-bank governors. Also, with a view to giving greater influence to China, the Bush administration has pushed hard to change the voting quotas within the International Monetary Fund.

### **Understanding China's FTA outcomes**

Chinese analysts have had a rather thorough discussion about selecting China's FTA partners. They take into consideration economic, political and strategic factors. The realist relative gain is what China is really concerned about and the liberal absolute gain takes a back seat in China's selection of FTA partners. "What we can get from the FTA should be the key issue in selecting partners," said a Chinese analyst ("China-Pakistan FTA to promote bilateral trade" 2006). It is generally agreed that priority should be given to China's neighbouring countries, then to the countries that either have an economy complementary to China's or rich resources or are emerging markets. Thus Beijing was right in initiating FTA negotiations with ASEAN. Other FTA negotiation partners in Asia should be South Korea and Japan in Northeast Asia and then Pakistan and India in South Asia. Beyond Asia, China's ideal FTA partners are United Arab Emirates in the Middle East, Chile in Latin America, Australia in Oceania and South Africa in Africa. However, FTA negotiations are two-way communications and China has to be flexible in prioritising its FTA partners. For instance, in Oceania, it is New Zealand, instead of Australia, that has signed an FTA with China.

This section investigates China's current FTA partners. China's CEPAs with Hong Kong and Macao are different from China FTAs in that both Hong Kong and Macao are China's special administrative regions instead of sovereign states.

### *Inside Asia: Pakistan and ASEAN*

#### Pakistan

Pakistan's economic value to China is limited. Its trade with China accounted for just 0.3 percent of China's total trade in 2006. Unlike countries such as Chile, Pakistan can hardly be used as a springboard to other economies. This does not mean Pakistan has no economic potential for China. Chinese investment in Pakistan is believed to increase substantially in the coming years ("Pakistan: China displays growing interest in Pakistan" 2007). Nevertheless, Pakistan's value to China is largely political and strategic.

It is well known that Pakistan has been China's strong ally for decades. It has consistently supported China in the United Nations on issues like China's human rights record and Taiwan. It has also played a crucial role in Sino-US rapprochement in the early 1970s. Although China has substantially improved its relations with India, a giant in South Asia who has regarded China as a major enemy ever since the 1962 Sino-Indian war, Pakistan's strategic importance to China has by no means declined. After all, Beijing is wary of U.S. and Japanese attempts to deepen their strategic cooperation with India.

Pakistan's strategic value to China lies not only in its support for China on various political and security issues but also in its vital strategic location. It not only neighbors China, India and Arabian Sea, but also is close to the Middle East and Central Asia, two oil-rich regions. The Gwadar Port in Pakistan's Balochistan Province is only 72

kilometers away from Iran, and about 400 kilometers away from the Strait of Hormuz, the only sea passage to the open ocean for large areas of the petroleum-exporting Persian Gulf states. The Chinese hope that they will one day ship Persian Gulf oil from Gwadar overland through Pakistan to China. That will cut transport by 12,000 miles, shaving a month off the journey's time and 25 percent off the fees (Montero 2007). Perhaps more importantly, it would give China an alternative to the Malacca Strait, an increasingly busy and dangerous Strait which is plagued by pirates and vulnerable in times of great power conflicts.

While Sino-Pakistan political and security relations are deep-rooted, their economic relations have been shallow. Chinese analysts conclude that the Sino-Pakistan "all-weather, all dimensional" strategic relationship is seriously unbalanced. It is therefore of strategic importance to strengthen the bilateral economic relationship (Huang, Zhao and Bi 2008: 64-65). In Pakistan, in spite of some economic concerns, the strategic value of an FTA with China is also well recognized. A Pakistani commentary notes that

Spanning over five and a half decades, the historic bonds between China and Pakistan are the living example of a relationship based on trust, equity and respect. . . . The FTA is acknowledgement of the realization that to sustain cooperation and . . . nurture the wholistic and strategic relationship, major advances had to be made in the economic fields ("Pak-China FTA" 2006).

### ASEAN

Political competition is also prominent in China's FTA with ASEAN. To be sure, the economic necessities for the China-ASEAN FTA (CAFTA) were not difficult to identify. Bilateral trade grew rather rapidly, from US\$7 billion in 1990 to US\$39.52 billion in 2000. The average growth rate was 18.8 percent. In 2000, the growth rate was as high as 45.3 percent. In 1991, ASEAN's share of China's foreign trade was 5.8 percent. By 2000,

it had increased to 8.3 percent and ASEAN had become China's fifth largest trading partner. Meanwhile, the share of China in ASEAN's trade expanded from 2.1 percent in 1994 to 3.9 percent in 2000, making China ASEAN's sixth largest trading partner. In 2002, with China's entry into the WTO, China-ASEAN trade increased by 31.6 percent (ASEAN-China Expert Group on Economic Cooperation 2001: 1). According to the ASEAN-China joint expert group, the CAFTA would increase ASEAN's exports to China by US\$13 billion or by 48 percent while China's exports to ASEAN would expand by U.S.\$10.6 billion or by 55.1 percent. At the same time, ASEAN's GDP would increase by 0.9 percent or by U.S.\$5.4 billion while China's GDP would rise by 0.3 percent or by U.S.\$2.2 billion in absolute terms (ASEAN-China Expert Group on Economic Cooperation 2001: 31, 150).

Arguably, both China and ASEAN would benefit from CAFTA in the long term as the competition resulted from CAFTA would help ASEAN and China to increase the economic efficiency and competitiveness of their business sector and attract more foreign direct investment (FDI) inflows (Cai 2003: 401). Some also argued that the pact would in the longer term be in China's favor as Chinese manufacturers would break into Southeast Asian export markets and the Chinese economy would also benefit from a stable supply of commodities and raw materials (Vatikiotis and Hieber. 2003: 28.). However, the short-term economic impacts of the CAFTA on both China and ASEAN were less certain. The impacts could be negative. A key principle for establishing FTAs is the complementarity of the two economies and ASEAN and China were more competitive than supplementary in trade structure. This was reflected in the fact that China and ASEAN were not each other's major export markets. Wong and Chan (2003: 518) noted that from 1980 to 2000,

the ASEAN-5 (Indonesia, Malaysia, Philippines, Singapore and Thailand) received only an average of 6.4 percent of China's total exports while ASEAN-5's exports to China constituted only 5.5 percent of China's total imports. From the perspective of ASEAN-5, exports to China in this period accounted for only 2.4 percent of its total exports and its imports from China were just 2.6 percent of its total imports. In terms of investment, the FDI share of the ASEAN-5 in China accounted for only six percent in 2001 (Wong and Chan 2003: 523). Wong and Chan (2003: 526) hence concluded that "there are more possibilities that China and ASEAN would compete, rather than complement one other."

China's strong interest in CAFTA thus cannot be fully explained by economic interests. More incentives can be found in Chinese political and strategic calculations. Lee Kuan Yew (2007: 25) observed that China's decision-making on CAFTA was "based on strategic considerations that override such competing domestic interests as importers versus exporters and agriculturists versus industrialists." Chinese analysts agree that China's decision was, to a great extent, a politically driven move (Qiu 2005: 8-13; Li, Xia 2005: 62).<sup>6</sup>

First of all, to promote China's peaceful rise is particularly important in East Asia. While China contributed a great deal to the trade within East Asia, its export competition with the newly industrialized economies in the region has increased from eight percent in 1990 to 20 percent in 2002. It is therefore important to coordinate economic interests with ASEAN states, which has strategic implications.

Southeast Asia is geo-politically significant to China, not only because much of China's trade and oil from the Middle East passes through the region but also because of

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<sup>6</sup> This author's interviews in Beijing and Shanghai in October and November 2005 also confirmed this point.

conflicting maritime claims. China, as a rising power, has been a strong supporter for multipolarity in world politics and ASEAN is crucial in that respect. Southeast Asia is also important in China's effort to counter a perceived US containment-of-China strategy and to marginalize Taiwan politically.

To cement closer economic relations with ASEAN would increase China's regional influence at the expense of the United States, Japan and other major economic powers. The FTA deal was just part of Beijing's concerted effort to embrace ASEAN from all directions. In November 2002, when China and ASEAN signed the CAFTA, they also signed off on three other agreements, including agreements on cooperation in new areas like drug trafficking, agricultural cooperation and a landmark declaration on territorial disputes in the South China Sea. It was thus observed that "China moved ahead of rival Japan in setting the stage for economic and political ties with the region" (de Castro 2002).

Chinese analysts have noted a number of Chinese interests in establishing the CAFTA, as summarized by Wang Shuguang ((2005: 24-25):

- To demonstrate to the world that China is determined to open up further and to recognize, accept and integrate into the existing international system;
- To further improve relations with China's peripheral states in order to create an external environment which is conducive to China's economic development;
- To use it as a base for China to participate in international competition. Economically, CAFTA will help reduce China's reliance on North American and European markets. Politically, ASEAN is an important springboard for China to go to the world and could be an important supportive political force;
- To explore regionalism that serves China's interests;
- To help address ASEAN's concerns about "China threat";
- To help resolve the issues about ethnic Chinese in ASEAN member states.

### *Outside Asia: New Zealand and Chile*

New Zealand and Chile have some similarities. First, both are relatively small and open economies, reflecting Beijing's attempt to learn about and try FTA negotiations. Second, both economies are more or less complementary to the Chinese economy. Third, the two countries have had a strong political relationship with China. Finally, both have been leading the support for China's economic integration with the world economy.

#### New Zealand

New Zealand from the very beginning was determined to become the first developed country to sign an FTA with China. Australia, China's priority FTA negotiation partner in Oceania, tried to compete with New Zealand. However, due to their differences on market access, especially for agricultural products, no significant progress has been achieved in the negotiations since the eighth round in April 2007 (Department of Foreign Affairs and Trade, Australian Government 2008). On the other hand, China has been grateful to New Zealand for its consistent support in the past. New Zealand was the first developed country to sign a WTO agreement with China, the first developed country to recognize China as a "market economy", which was a huge boost to China's effort to be accepted as a "market economy".

There are a number of other factors for New Zealand becoming the first developed country to sign an FTA with China. As mentioned earlier, the New Zealand economy is relatively small, open and complementary to the Chinese economy and New Zealand has a good political relationship with China. It was an ideal country for China to

learn about and practice FTA negotiations. Commenting on China's FTA negotiations in March 2003, Long Yongtu, who was chief trade negotiator for China's entry into the WTO in 2001, said that "China has just entered into the WTO. We are really not familiar with all these very sophisticated negotiations and also our negotiating capacities are not very strong; so we have to focus on a few things rather than try to do many things at the same time" (Lee, Rebecca 2003).

### Chile

Similarly, Chile is a relatively small trading partner to China but has a few firsts in its relations with China. It was the first Latin American country to diplomatically recognize the PRC, the first Latin American country to recognize China's "market economy" status and the first Latin American country to conclude WTO membership accession negotiations with China.

Compared with New Zealand, Chile is more important to the Chinese economy. What attracts China perhaps as much as trade opportunities is the fact that Chile is a liberal, cosmopolitan state that has already negotiated full or partial FTAs with over 30 partners in four continents, and that it has a special relationship with the United States. In that respect, Chile is a Latin American counterpart of Singapore; both have become FTA "hubs" in their respective regions. A good example is Chinese exports of toys to Latin America. Latin America was believed a most difficult market for Chinese toy exporters. It was the only region where Chinese toy exporters faced dumping charges. After the signing of China-Chile FTA in 2005, Chinese toy exports to Chile, Mexico, Argentina and Brazil increased by 50 percent, 33 percent, 23 percent and 58 percent respectively.



This is despite the fact that the China-Chile FTA did not come into effect until October 1, 2006. The increase was so dramatic that Chinese analysts called for self regulations to avoid repercussions (Zeng 2007: 12-13).

Concerns over the competition of the proposed Free Trade Area of the Americas (FTAA) contributed to China's eagerness to conclude its FTA negotiations with Chile. China was worried that the proposed FTAA would generate more competition from Latin American economies in the U.S. market. The Chinese still remember the tariff discrimination that their country suffered after North American Free Trade Agreement (NAFTA) came into effect in the 1990s. Before NAFTA, China had the largest share of the U.S. textile products market. During the first three years after NAFTA was signed by the United States, Canada and Mexico in 1994, Mexico saw its exports of male shirts to the United States soar by 122.9 percent while those of China declined by 38.1 percent. For sports wear exports, Mexico gained 769.3 percent while China lost 33.8 percent ("China, India to advance feasibility research on regional trade arrangement" 2007.) By 1998, Mexico had replaced China as the largest exporter of textile products to the United States. It is predicted that the FTAA will have an even stronger impact on China's exports. An FTA with Chile will give China's traders a beachhead from which to expand their economic activities into the Latin America region and make the FTAA work for China rather than against it (Yang, Zhimin 2004:48-50). Pablo Cabrera, the Chilean Ambassador to China, said that Chile expected to provide Chinese companies with a new entry point to the American market. "South America, even the whole of America, will become a complete free trade area for China," Cabrera claimed (Liu and Jiang 2005).

An FTA with Chile also serves China's energy and natural resources security interest. While China is the world's largest copper importer with its copper consumption accounting for about 22 per cent of world total in 2004 (Chen, Hua 2005). Chile is the world's largest copper supplier. Chile annually produces 4.9 million tons of copper. About 850,000 tons are exported to China (Zhang, Jin 2004). The two countries have already vowed to strengthen co-operation on copper mining. Currently copper accounts for 62 percent to 68 percent of Chilean exports to China (Zhang, Jin 2004).

### **Conclusion**

Before November 2000 when Chinese Premier Zhu Rongji surprised the world with a proposal to establish a free trade area with all ten ASEAN economies by 2010, China had been "more of a follower than a leader when it came to be dealing with multilateral economic arrangement" (Cheng 2006). Since then, China has engaged in an FTA offensive and is an influential driving force of East Asian regionalism. As a trade-oriented economy, China has a strong interest in promoting trade liberalization. Concrete benefits include lowering costs, expanding exportation, diverse markets, and helping address the anti-dumping concerns.

China's interest in FTA talks should be examined against the background that "the use of FTAs in geopolitical jockeying is reaching new heights in East Asia" (Caryl 2007). Political and strategic considerations can play a decisive role in China's FTA decisions. It is no coincidence that China began its FTA initiatives in Southeast Asia where China has had historical influence that it aspires to re-establish, particularly in rivalry with Japan and the United States. At the same time, FTAs can also be useful

vehicles for China to promote its “peaceful development” vision and the notion that China’s development is an opportunity rather than a threat to other countries. China’s FTA negotiation partners include some resource-rich countries, such as GCC and Australia. In terms of legal competition, China still is in its learning curve. Beijing is relatively new to the existing international trading system and has been focusing on how to make good use of it instead of challenging it.

The outcomes of China’s FTA negotiations so far have highlighted the competition factor in Chinese selection of FTA partners. In Asia, China’s FTAs with Pakistan and ASEAN are mainly driven by strategic and political considerations. Outside Asia, New Zealand became the first developed country to conclude FTA negotiations with China largely because as a small, open economy New Zealand was relatively harmless to the Chinese economy. Also, China intended to reward New Zealand for its exemplary role in supporting China’s effort to participate in the world economy. Similarly, Chile is a small and open economy with a strong political relationship with China. But more importantly, it can be China’s springboard to Latin America. All these cases point to Chinese realist calculation of relative gains although China’s FTA strategy is in line with its slide towards liberalism. The cases demonstrate that China has been competing for economic, political and strategic interests.

Whom has China been competing with then? The target countries can be specific, but not always. In the case of Pakistan, China is competing with other great powers for strategic interests and for its energy security. In ASEAN, China was mainly competing with Japan and the United States for future regional leadership role. China was also competing with “China threat theory” supporters in that the CAFTA will substantially

improve China's image by demonstrating China's rise as an opportunity. The competition factor can be applied to the New Zealand case in that New Zealand played an important role in Chinese campaign for the recognition of its market economy status. Chile, on the other hand, is important to China's broadly defined economic competition in that it can be China's springboard to Latin America.

**Table 1. China's FTA Offensive (As of May 2008)**

Partner	Status	Trade Volume* % of 2006 total		FDI Volume* % of 2006 total		Issue Scope				
		Export	Import	Inflow (Actually utilized)	Outflow (Non-financial)	Investment	Service	Environment	Labor	Economic cooperation
Hong Kong	In force (Jan 2004)	16.06	1.36	32.11	39.30	Yes	Yes	No	No	Yes
Macao	In force (Jan 2004)	0.23	0.03	0.96	0.82	Yes	Yes	No	No	Yes
ASEAN	In force (Jul 2005)	7.36	11.31	5.32	2.82	Negotiation	Yes (Jul 2007)	No	No	No
Chile	In force (Oct 2006)	0.32	0.72	0.00	0.00	Negotiation	Negotiation	No	No	Yes
Pakistan	In force (Jul 2007)	0.44	0.13	0.00	0.00	Yes	Negotiation	No	No	No
New Zealand	Signed (Apr 2008)	0.17	0.17	0.13	0.00	Yes	Yes	Yes	Yes	Yes
GCC	Negotiation (Jan 2005)	1.81	3.11	0.24	0.00	+++++				
Australia	Negotiation (May 2005)	1.41	2.44	0.88	0.50	+++++				
Singapore	Negotiation (Oct 2006)	2.39	2.23	3.59	0.75	+++++				
Iceland	Negotiation (Apr 2007)	0.00	0.00	0.00	0.00	+++++				
Peru	Negotiation (Jan 2008)	0.00	0.00	0.00	0.00	+++++				
SACU	Negotiation Announced (Jun 2004)	0.61	0.53	0.16	0.23	+++++				
India	Study completed (Oct 2007)	1.50	1.30	0.00	0.00	+++++				
Japan-Korea	Study	14.05	25.95	13.48	0.39	+++++				
Japan	Study	9.46	14.62	7.30	0.22	+++++				
South Korea	Study	4.59	11.34	6.18	0.16	+++++				
Switzerland	Study	0.26	0.54	0.31	0.00	+++++				

\* National Bureau of Statistics of China 2007.

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