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China's Trade Ambitions: Strategy and Objectives behind China's Pursuit of Free Trade Agreements

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Executive Summary

Under the leadership of President Xi Jinping, China is engaging in a multipronged campaign to sign free trade agreements (FTAs).[*] After concluding several FTAs with mostly small, developing countries, in 2013 China signed its first FTAs with advanced European economies (Switzerland and Iceland). In 2014, Beijing finalized an agreement with Australia, after 11 years of negotiations. Beijing is also eager to conclude long-running talks with South Korea and Japan. At the regional level, Beijing is party to the Regional Comprehensive Economic Partnership (RCEP), a "mega-regional" agreement that includes the ten members of the Association of Southeast Asian Nations (ASEAN) and six major economies in the Asia Pacific. RCEP held its seventh round of negotiations in February 2015.

This paper analyzes China's preferential trade strategy and rationale. It finds that China has signed trade agreements primarily with countries that are neither significant in the global economy nor vital to China's export sector. Indeed, several partners enjoy bilateral trade surpluses with China, and have comparative advantages in industries that China may want to protect from outside competition. The way in which China negotiates trade deals is also confounding. Unlike the United States, China appears to lack a modus operandi, so that the scope, strength, and details of its agreements vary widely. Some appear exceedingly generous to the trade partner, while others aggressively promote and protect domestic industries. With respect to services, investment, and other advanced provisions, China tends to fall well short of U.S. standards; yet it also demonstrates greater ambition and flexibility than developing country peers like India and Brazil (see Section 2).

Because China does not publish an official and detailed preferential trade policy, scholars are left to surmise its rationales. Prevalent theories are that China:

- *Pursues narrow regional security interests.* Much of China's preferential trade partnering revolves around the One China policy, countering the "China threat" perception, and assuming regional leadership. China signed FTAs with Hong Kong and Macau soon after the handover of these jurisdictions to the Mainland. China has also sought to constrain Taiwan's independence by (a) signing trade agreements with countries that recognize the People's Republic of China; (b) dissuading other countries from signing trade agreements with Taiwan; and (c) signing a trade agreement directly with Taipei but on terms designed to reinforce the non-sovereign status of the Republic of China on Taiwan. China's trade agreement with ASEAN aimed to counter concerns about China's entry into the World Trade Organization (WTO), while capitalizing on the regional solidarity that followed the 1997–1998 Asian Financial Crisis.
- *Promotes an alternative model of trade that differs from the United States*. In its negotiations with potential FTA partners, China appears to prioritize "cooperation" over narrow economic self-interest. This normative approach allows China to justify lower-standard agreements, as well as exploit misgivings some countries have about the United States' more ambitious agreements.
- *Jockeys for a better position in the international trade regime.* Unlike small countries, China, as a major trading hub, has relied less on trade agreements to avoid trade diversion. It has, however, been preoccupied with its status as a "non-market economy" in the WTO. China has therefore made market economy recognition a prerequisite for negotiating preferential deals. Engaging with small, geographically dispersed partners has also allowed China to access regional trade networks and gain negotiating experience at minimal risk.
- *Seeks to improve its resource security.* Several of China's FTA partners are significant exporters of commodities vital to China's manufacturing, energy, and agricultural sectors. China has attempted to use

[*] Free trade agreements (FTAs) are a form of preferential trade agreements that involve deeper economic integration, usually through elimination of tariffs on some or all goods between the participating countries in addition to measures affecting such issues as intellectual property, investment, and financial services. There are other, more advanced forms of trade agreements, such as customs union, but FTAs are the most common type according to the World Trade Organization. For more on preferential trade agreements as a feature of international trade, see World Trade Organization, *World Trade Report 2011: The WTO and Preferential Trade Agreements: From Co-existence to Coherence,* July 20, 2011. *https://www.wto.org/english/res_e/publications_e/wtr11_e.htm*.

trade agreements to negotiate special clauses that ensure stable and affordable commodity supplies and afford wider access for Chinese resource investors.

- *Favors protectionist interest groups in negotiations.* China is home to powerful interest groups in government and industry that operate under the aegis of market-distorting policies. China thus prefers trade agreements with smaller countries that either do not have the leverage to exact concessions or are unable to inflict substantial damage on Chinese industry.

While all these theories have merit, this paper argues that China's rationale for pursing FTAs is changing over time (see Section 3). On the one hand, China's new leadership is under pressure to rebalance the economy toward services, consumption, and higher-value industries. China is beginning to ship capital, people, and services—rather than solely manufactured goods—overseas. This appears to have made the government more amenable to economically meaningful agreements with large and advanced economies, even to the detriment of some domestic interest groups. There is a fluid interplay between China's trade agreement negotiations, unilateral reforms (e.g., the Shanghai Free Trade Zone), bilateral investment treaties, and WTO plurilateral initiatives. At the Asia Pacific Economic Cooperation (APEC)[*] Ministerial Meeting in 2014, China tabled a proposal to revive talks for a Free Trade Agreement of the Asia Pacific (FTAAP).[1]

On the other hand, China is clearly using its newfound power to become more assertive. Even as opposition to China's aggressive security posture mounts across Asia, U.S. treaty allies such as Japan, South Korea, and Australia increasingly depend on economic relations with China for their own growth. China has used this material dependence to its advantage, while resorting increasingly to a "divide and conquer" strategy to pit different countries against one another. China's apparent reformist agenda may also turn out to be a "Trojan horse" strategy to enter and then derail U.S.-led trade initiatives in the Asia Pacific.

China's approach to preferential trade is inconsistent and at times difficult to comprehend. China's discernible objectives—such as achieving recognition as a market economy and exerting political influence over its neighbors—are often very different from the objectives of the United States or other emerging economies. While China so far has preferred to make generous concessions and negotiate agreements with smaller partners, it is becoming more assertive. The new leadership in Beijing could use preferential trade to spur a new round of domestic reform, akin to what occurred ahead of China's WTO accession. Yet there is also a risk that China will exploit power asymmetries and loopholes in the international system to achieve its own interests, both in the economic and security realms.

The current and future U.S. administrations will have to deal with China's preferential trade agenda on two levels. Bilaterally, the United States will need to gauge China's commitment to reform based on specific items discussed in the U.S.-China Strategic and Economic Dialogue and the negotiations for a bilateral investment treaty. Multilaterally, the United States will need to monitor how its own economic integration efforts in Asia complement or conflict with China-led initiatives.

[*] The 21 APEC members are: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Singapore, South Korea, Taiwan, Thailand, the United States, and Vietnam. Asia-Pacific Economic Cooperation, "Member Economies." *http://www.apec.org/About-Us/About-APEC/Member-Economies.aspx*.

Introduction

The world finds itself at an important juncture in international trade policy as the United States and China are pursuing a series of large-scale trade agreements. Washington hopes to conclude mega-regional trade agreements ("mega-regionals") with the European Union (the Transatlantic Trade and Investment Partnership, or TTIP)* and 11 Asia Pacific countries (the Trans-Pacific Partnership, or TPP)† in the next one to two years. Beijing is engaged in a wider set of trade agreement talks, including a regional agreement involving the Association of Southeast Asian Nations (ASEAN) and a tripartite agreement with Japan and South Korea. In 2013, China signed bilateral free trade agreements (FTAs) with Iceland and Switzerland and, most recently, concluded a bilateral agreement with Australia.

These initiatives could shape future rules and norms for international trade at a time of impasse in the World Trade Organization (WTO) Doha Round. They are also taking place at a time of political and economic uncertainty. Many of the world's economies are looking to liberalize trade in order to stimulate growth in a post-recessionary economy. The United States seeks to use mega-regionals to drive its "rebalance to Asia" and strengthen its alliance with western Europe. Meanwhile, China's new leadership has placed a priority on enacting a series of economic reforms, but has also been aggressive in asserting China's regional interests.

Is China's preferential trade strategy distinctive? Do its preferences change over time? Does China's trade strategy run counter to U.S. objectives, or is there room for convergence around common norms and agreements?

This paper analyzes China's preferential trade policies and their implications for the United States. Section 1 begins with a brief overview of China's FTAs. Section 2 looks at the nature of China's trade partners and the way it negotiates its agreements. Section 3 considers China's economic and security rationales for pursuing FTAs, and how they are changing over time.

The paper draws on a diverse set of data, including trade statistics from international organizations and U.S. and Chinese government sources; academic studies on China's FTAs (see References); Chinese-language policy articles; and trade agreement documents.

The Current State of China's Trade Agreements

After 15 years as a candidate, China joined the WTO in December 2001. China's accession was a major turning point in the liberalization of its economy. By joining the WTO, China transitioned from a closed-off economy to one more integrated with the global community. In turn, accession required China to give preferential treatment to all members of the WTO, to give equal treatment to competing suppliers, and not to discriminate between domestically produced and imported goods.[2] Asia is a relative latecomer to trade agreements, but over the past decade, the number of trade agreements involving at least one country from the region has increased dramatically—creating the so-called "Asian noodle bowl." According to the Asian Development Bank, as of July 2014, there were 278 FTAs in Asia (up from 55 in 2000), including 144 signed, 69 being negotiated, and 65 proposed.[3]

Since its accession to the WTO, China has actively pursued bilateral and regional trade agreements, concluding FTAs in various regions around the globe, all with varying provisions. The following is an outline of China's trade agreements that have been signed, are currently under negotiation, and are under consideration.

* TTIP is an FTA being negotiated between the United States and the EU. See Shayerah Ilias Akhtar and Vivian C. Jones, "Proposed Transatlantic Trade and Investment Partnership (T-TIP): In Brief," *Congressional Research Service*, June 11, 2014.

† The TPP is a trade agreement currently being negotiation by the United States and 11 other countries in the Asia Pacific (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam). See Ian F. Ferguson, et al., "The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress," *Congressional Research Service*, March 20, 2015.

According to China's Ministry of Commerce (MOFCOM), China has signed trade agreements with 12 different partners (see Table 1).* Given that ASEAN has 10 members, and that MOFCOM (for political reasons) does not categorize its Cross-Strait Economic Cooperation Framework Agreement (ECFA) with Taiwan as an FTA, China in fact has agreements with 22 trade partners. In addition to the Regional Comprehensive Economic Partnership (RCEP), Beijing is also considering or negotiating six agreements comprising an additional 11 members. That brings China's total trade agreement partners, broadly speaking, to 33 countries.[4] If the Free Trade Agreement of the Asia Pacific (FTAAP) negotiations are started, as China proposed in 2014, the list of trade partners would grow even further.†

Table 1. China's Free Trade Agreements

Partner	First signed	Participants	Geography	Phasing of agreement	WTO reporting
Signed					
ASEAN	2002	Multi-Partner	Proximate	Step-by-step: Framework (2002), goods (2004), services (2007), investment (2009)	Enabling Clause & GATS Art. V
Hong Kong	2003	Bilateral	Proximate	Single undertaking	GATT Art. XXIV & GATS Art. V
Macau	2003	Bilateral	Proximate	Single undertaking	GATT Art. XXIV & GATS Art. V
Chile	2005	Bilateral	Distant	Step-by-step: goods (2005), services (2008)	GATT Art. XXIV & GATS Art. V
Pakistan	2006	Bilateral	Proximate	Step-by-step: goods (2006), services (2009)	GATT Art. XXIV & GATS Art. V
New Zealand	2008	Bilateral	Distant	Single undertaking	GATT Art. XXIV & GATS Art. V
Singapore	2008	Bilateral	Proximate	Single undertaking	GATT Art. XXIV & GATS Art. V
Peru	2009	Bilateral	Distant	Single undertaking	GATT Art. XXIV & GATS Art. V
Costa Rica	2010	Bilateral	Distant	Single undertaking	GATT Art. XXIV & GATS Art. V
Taiwan	2010	Bilateral	Proximate	Step-by-step: framework (2010), goods and services (not signed yet)	GATT Art. XXIV & GATS Art. V
Switzerland	2013	Bilateral	Distant	Single undertaking	GATT Art. XXIV & GATS Art. V
Iceland	2013	Bilateral	Distant	Single undertaking	Unnotified
Australia	2014	Bilateral	Distant	--	Early notification
Under negotiation					
Norway	--	Bilateral	Distant	--	Early notification
Gulf Cooperation Council	--	Multi-Partner	Distant	--	Unnotified
South Korea	--	Bilateral	Proximate	--	Unnotified
Japan and Korea	--	Multi-Partner	Proximate	--	Unnotified

Source: China Ministry of Commerce; WTO.

* One agreement not listed here is the Asia Pacific Trade Agreement, formerly known as the Bangkok Agreement. It comprises China, Bangladesh, India, Laos, South Korea, and Sri Lanka. The agreement has little significance in international trade. China's Ministry of Commerce. *http://fta.mofcom.gov.cn/topic/enpacific.shtml*.

† There is significant overlap in membership between the FTAAP and the RCEP. Since China already has separate FTAs with non-RCEP members Hong Kong, Taiwan, Chile, and Peru, the only APEC members who will not be linked to China after RCEP's conclusion through some form of preferential trade agreement are the United States, Canada, Mexico, Russia, and Papua New Guinea.

Although Beijing only signed its first FTA in 2002, it has now caught up with Washington. China has 22 partners across 12 agreements; the United States has 20 and 14, respectively (see Table 2).

Table 2. Comparison of U.S. and Chinese FTAs by Time Period

	United States		China	
	Agreement	Number	Agreement	Number
1980s	Israel ('85)	1	--	0
1990s	NAFTA ('94)	1	--	0
2000-2005	Jordan ('04), Australia ('04), Chile ('04), Singapore ('04), CAFTA ('05)	5	ASEAN ('02), Hong Kong and Macau ('03), Pakistan ('05), Chile ('05)	4
2006-2010	Bahrain ('06), Morocco ('06), Oman ('06), Peru ('07)	4	Costa Rica ('07), New Zealand ('08), Singapore ('08), Peru ('09)	4
2011-2015	Panama ('11), Colombia ('11), South Korea ('11)	3	Taiwan ('10), Switzerland ('13), Iceland ('13), Australia ('14)	4
Total		**14**		**12**

Note: NAFTA = North American Free Trade Agreement; CAFTA = Central American Free Trade Agreement. The table does not include the U.S.-Canada FTA (signed in 1988), which was, with the addition of Mexico in 1994, superseded by NAFTA. FTAs under negotiation or consideration are not listed.
Source: China's Ministry of Commerce; Office of the U.S. Trade Representative.

While committing to the multilateral trade system and its rules as the cornerstone of its foreign economic and trade relations, China has also attached importance to promoting bilateral and regional economic and trade cooperation. Currently over 150 countries and regions have signed agreements on bilateral trade or economic cooperation with China. China has witnessed steady growth in its trade with developed countries and realized complementary advantages as well as reciprocity and mutual benefit. China's trade with developing countries is experiencing robust growth, and there is huge potential to be further explored.

China is an active participant in the Asia Pacific Economic Cooperation, the ASEAN meetings with China, Japan and South Korea, the East Asia Summit, the Forum on China-Africa Cooperation, the Greater Mekong Sub-region Economic Cooperation Committee, the Central Asia Regional Economic Cooperation Committee, the Greater Tumen Initiative, and other regional and sub-regional economic cooperation mechanisms. China has also been active in pursuing bilateral investment treaties (BITs) with other countries: It has concluded 130 BITs, of which 108 are in force.[5]

Asia Pacific Region

Asia Pacific Trade Agreement (APTA)

The Asia Pacific Trade Agreement, formerly known as the Bangkok Agreement, was led by the United Nations Economic and Social Commission for Asia and the Pacific and originally signed by Bangladesh, India, South Korea, Sri Lanka, Laos, Philippines, and Thailand in 1975. The name was changed in 2005 to the Asia Pacific Trade Agreement during the third round of tariff concessions.[6] It is the sole operational trade agreement linking China with other major markets such as India and South Korea.[7] As the agreement only covers tariff reductions and does not include a services or investment agreement, it does not necessarily qualify it as a full FTA. It went into force in July 2006.[8]

ASEAN-China Free Trade Area (ACFTA)

The ASEAN-China Free Trade Area (ACFTA) is a regional FTA between China and the ten members of ASEAN. The establishment of the FTA was officially proposed by Chinese Premier Zhu Rongji at the ASEAN-China summit in November 2001. It was seen as an initiative to ease ASEAN member countries' concerns regarding China's accession to the WTO.[9]

Progress was made when the Framework Agreement on ASEAN-China Comprehensive Economic Cooperation was signed by both parties at the sixth ASEAN-China Summit in November 2002, establishing a legal structure to govern future economic cooperation. Formal talks for the ACFTA began in 2003 and agreements on trade in goods, trade in services, and investment were signed separately over the following four years. In November 2004, the first agreement on trade in goods was signed. In January 2007, China and ASEAN signed an agreement on trade in services, which entered into force in July of the same year. Finally, in August 2009 the two parties signed an agreement on investment.[10] The ACFTA, formally established in January 2010, is the biggest trade agreement among emerging economies. After the European Union (EU) and NAFTA, the ACFTA is the third largest regional trading agreement by value.[11]

Reflecting China's "big country morality" strategy (i.e., providing agreements that benefit smaller countries), then Minister of Commerce Bo Xilai stated that China is to "give a lot" while receiving little in the negotiations with ASEAN.[12] As a result of the agreement, average tariffs on imports of ASEAN-origin exports to China were lowered from 9.8 percent to 0.1 percent. The average tariff on Chinese-origin exports to the original six ASEAN members—Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand—was reduced from 12.8 percent to 0.6 percent. The agreement looks to implement a zero-rate tariff for 90 percent of Chinese goods exported to the four new members of ASEAN—Cambodia, Laos, Myanmar, and Vietnam—in 2015.[13] However, there are shortcomings in the ACFTA as the trade in goods agreement allow each country to register hundreds of sensitive goods such as electronic equipment, automotive vehicles and parts, and chemicals that are not subject to tariff reductions until 2020.[14]

Apart from the economic benefits, the ACFTA was also driven by strategic considerations. China wanted to reassure its neighbors (especially in the light of tensions over territorial disputes in the South China Sea), and increase its influence and counterbalance U.S. influence in the region.[15] In August 2013, China's Premier Li Keqiang said that China considers its relationship with ASEAN as a priority in its regional diplomacy.[16]

The agreement did not come without controversy. ASEAN members were suspicious about China's potential political motivations regarding the agreement. Indonesia led opposition to the trade pact, fearing that its industries would lose competitiveness in the region.[17]

A 2012 report by the Asian Development Bank showed that the ACFTA has led to a substantially higher volume of bilateral trade between ASEAN and China. Recently, Premier Li set high goals for ASEAN-China trade, aiming to increase ASEAN-China bilateral trade to $1 trillion and bilateral investment to $150 billion by 2020.[18] Total trade between China and ASEAN was $480.5 billion in 2014, while the total stock of China's foreign direct investment (FDI) in ASEAN in 2013, the latest available, was $35.7 billion.[19] Although the ACFTA suggests mutually beneficial economic relations, the reality is that since full enactment of the agreement in 2010, ASEAN's goods trade with China has gone from a surplus to a nearly $45 billion deficit in 2013.[*]

Hong Kong and Macau Closer Economic Partnership Agreement (CEPA)

The CEPA is an application of the "One Country, Two Systems" framework,[†] and is a trade agreement signed by the Central Government with the Special Administrative Regions (SARs) of Hong Kong and Macau.[20] The CEPA

[*] For an assessment of China-ASEAN economic relations, see Nargiza Salidjanova, Iacob Koch-Weser, and Jason Klanderman, "China's Economic Ties with ASEAN: A Country-by-Country Analysis," *U.S.-China Economic and Security Review Commission*, March 17, 2015. *http://www.uscc.gov/Research/china%E2%80%99s-economic-ties-asean-country-country-analysis*.

[†] The "One Country, Two Systems" framework is a policy measure adopted by China following the establishment of Hong Kong and Macau as SARs. The system grants Hong Kong and Macau the right to self govern their economy and political system to a certain extent, excluding foreign affairs matters.

with Hong Kong was signed in April 2010 followed by the signing of the Macau CEPA in October of the same year.

Pakistan FTA

China's FTA with Pakistan—its "all-weather friend" dating back to the Cold War—was signed in November 2006, and went into force on July 2007.[21] The agreement, which extended the 1989 China-Pakistan BIT, included most favored nation (MFN) treatment, and is regarded as the first comprehensive FTA signed by China.[22] The agreement is considered comprehensive because it includes tariff and investment provisions, as well as market liberalization provisions. Under the agreement, both countries agreed to eliminate tariffs on 35 percent of products upon signing of the FTA, and to liberalize further during Phase II on no less than 90 percent of products within a "reasonable period of time" to be negotiated by the parties.[23] China and Pakistan started negations on Phase II in January 2015.[24]

China imports mainly textiles from Pakistan, which accounted for over two-thirds of China's imports from Pakistan in the two years prior to signing the agreement. Pakistan imports mainly machinery and chemicals from China.[25] China's trade with Pakistan has remained low: In 2012 it only accounted for 0.3 percent of China's total trade.[26]

As the marginal amounts show, economic interest was not the motivating factor behind this FTA. Rather, the focus was on China's close political alliance with Pakistan, as well as its lending and investment there.[27]

New Zealand FTA

China's FTA with New Zealand, signed in 2008, is its first with a developed country (the FTA is an expansion of a 1988 BIT).[28] China made it a prerequisite—and was granted—recognition as a market economy to start negotiations.

The goal for New Zealand was not only to provide further investment protection mechanisms, but to include greater market access; however, China refused to include such provisions. China did agree to include New Zealand's proposal for a pre-establishment MFN clause "that ensures investors from New Zealand benefit from more preferable treatment due to China entering into negotiations with a third country in the future."[29] Services liberalization was likewise quite limited, and relied on a positive list approach (i.e., listing only the sectors that will be liberalized), rather than a negative list approach (i.e., listing only the sectors that will not be liberalized), much to New Zealand's disappointment.[30]

If investment and services liberalization were quite limited, the New Zealand FTA included significant liberalization in the goods sector. According to the New Zealand government, the FTA provides for elimination over time of tariffs on 96 percent of New Zealand's exports to China (an annual duty saving of NZ$115.5 million, or around $82.4 million), with remaining tariffs to be phased out by 2019.[31] Chinese exports to New Zealand would benefit from elimination of all tariffs by 2016.[32]

In a 2004 New Zealand-China joint study on the feasibility and impacts of a bilateral FTA, Chinese exports to New Zealand were estimated to grow by 10.9 percent in the first year after implementation of the FTA. New Zealand exports to China were expected to grow by 39 percent in the same year.[33] However, with the onset of the global financial crisis, China's imports from New Zealand grew by 23 percent and China's exports to New Zealand dropped by 22 percent one year after the agreement was implemented.[34] Although at the time of signing of the FTA China was running a $620 million trade surplus with New Zealand, in 2014 China's trade deficit with New Zealand was $4.7 billion.[35] China is New Zealand's biggest export market (in 2013, the latest available, China accounted for over 20 percent of New Zealand's exports), and New Zealand benefits from China's high demand for high-quality, safe consumer products, including infant formula, dairy, meat, seafood, and wine.

Singapore FTA

The China-Singapore FTA was signed in October 2008 and went into force in January 2009. The agreement was modeled after the ACFTA: Preferential policies for investment remained unchanged from the ACFTA, but the China-Singapore agreement on trade in goods and services was more comprehensive.[36]

The FTA with Singapore eliminated all tariffs on Chinese exports immediately, while 95 percent of items originating in Singapore became duty-free in January 2010.[37] Small and very rich, Singapore consistently appears at the top of global rankings for ease of doing business for its openness to trade, strong regulations, and low taxes, so it did not need much help from reduced tariffs. The main benefit to both countries lies in the liberalization of restrictions on the movement of people and individual income tax benefits.[38]

Economic Cooperation Framework Agreement (Taiwan)

The ECFA is similar to China's CEPA with Hong Kong and Macau. The ECFA is a framework agreement including only generic language on investment protection and facilitation.[39] It was signed in June 2010 and included 800 tariff reductions to take effect in phases over two years following implementation of the ECFA on January 1, 2011.[40]

Proponents touted the ECFA as a landmark agreement in easing cross-Strait tensions through deeper economic integration. Its advocates in Taiwan, including in the ruling Kuomintang party, justified the agreement under a strategy known as "China First." Under this strategy, Taiwan was motivated to sign the agreement with China in order to reduce China's pressure on other countries to avoid signing FTAs with Taiwan, because such agreements could undermine China's claim to sovereignty over the island.[41] In practice, Taiwan's integration into the global trading system expanded after the EFCA took effect: In 2013 Taiwan signed agreements with Singapore and New Zealand (though they are not called "free trade agreements").[42]

Both sides felt pressure to complete the ECFA, but for different reasons. The signing of ACFTA put pressure on Taiwan to complete the ECFA with China to avoid a loss in competitiveness to ASEAN counties. For example, Taiwan's petrochemical industry feared that delays in signing the ECFA would result in a loss of Chinese market share to ASEAN countries that would enjoy reduced Chinese tariffs on petrochemical imports under the ACFTA. China viewed the agreement as a move to help it advance towards reunification with Taiwan.[43] The ECFA has been controversial in Taiwan, and opponents of the agreement sought to pass a referendum to seek the approval of Taiwan citizens, though Taiwan's Kuomintang-led government rejected the proposal.[44]

In June 2013, Taiwan and China signed the Cross-Strait Service Trade Agreement (CSSTA), a follow-up to the ECFA. The CSSTA aimed to eliminate investment restrictions and other barriers across 11 service sectors in both countries. Taiwan investors would gain access to 80 service subsectors in China, including those in publishing, transportation, tourism, and entertainment. In return, Chinese investors would gain access to 64 service subsectors in Taiwan, including transportation, tourism, and traditional Chinese medicine.[45] The CSSTA met significant opposition in Taiwan: In March 2014, members of the Taiwan public launched massive protests, known as the Sunflower Movement, aimed at urging Taiwan's legislature to delay ratification of the CSSTA.[*] At the time of writing of this report, the CSSTA has not been ratified.

Australia FTA

China's FTA with Australia was negotiated for more than a decade, and was concluded at the arrival of President Xi in Australia in November 2014. Australia granted market economy status to China in 2005 at the start of the FTA negotiations (one of China's key prerequisites for FTA negotiations). Liberalization of the services sector appears to have been one stumbling block to a speedy conclusion of negotiations, with Australia keen on greater opening but China reluctant to liberalize beyond what it agreed to at WTO accession.[46] For Australia, whose economy depends on China more than any other developed country, gaining better access for its non-resource exports was a key priority (especially for agricultural products, where New Zealand, Australia's biggest competitor, had an edge since reaching its own FTA with China in 2008).[47] The FTA also includes an MFN clause.

The full text of the final agreement, which will be released in late 2015, is expected to include broad liberalization commitments across diverse industries, including financial services, education, healthcare, and tourism.[48] Australia's dairy farmers and winemakers will receive tariff-free access to China's market within four years.[49]

[*] For a discussion of public opposition to the CSSTA in Taiwan, including the Sunflower Movement, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, 482–484.

Both sectors have been growing their market share in China despite tariffs: Food safety concerns among ordinary Chinese have been boosting demand for imported dairy, while Australian wines have been gaining market share as Chinese consumers acquire a taste for imported alcohol.[50] Tariffs on beef, Australia's most valuable agricultural export, will be eliminated within nine years, while tariffs on live animals will be abolished within four years.[51]

On the investment side, China will provide a negative list of those sectors closed to investment, with all others open (details of the negative list have not yet been released). China has been experimenting with the negative list approach in the Shanghai Free Trade Zone (with mixed results) and is expected to field one in the BIT negotiations with the United States. The services sector barriers will remain high, however, with some small concessions in banking, legal services, and healthcare.[52]

Beyond the liberalization of goods (primarily consumable, which account for 93 percent of Australia's global exports by value) and investment, the FTA contains two important, China-specific carve-outs. The first concerns Australia's foreign investment review mechanism; the second, China's desire to import Chinese workers to work on projects it undertakes in Australia.

China insisted specifically that the Australian Foreign Investment Review Board (FIRB) revise its statutes on the treatment of Chinese investors. The FIRB reserved the right to screen any Chinese investment that (a) exceeded $200 million in value or (b) was made by a Chinese state-owned enterprise (SOE). China wanted SOEs to be exempt from an automatic trigger, and its investments to be screened only at the A$1 billion threshold, as is the case with U.S. and EU investors in Australia. In the end, Australia agreed to raise the screening threshold to A$1 billion, but held ground on SOEs, which will continue to face mandatory review.[53]

In the case of labor, the Australian government agreed to a "new case-by-case mechanism" for Chinese investors to bring workers to Australia "in areas of skills shortages."[54] This decision is politically sensitive, and faced Australian domestic opposition.[55]

Latin America

Chile FTA

The China-Chile FTA (China's first bilateral FTA and first with a Latin American country) was signed in November 2005, and entered into force in October 2006.[56] Similar to the economic agreements signed with Hong Kong and Macau, the China-Chile FTA only includes tariff cuts and provisions on investment promotion and facilitation. However, China and Chile are currently negotiating rules on investment.[57]

Maintaining competitiveness was a factor behind China's FTA strategy with Chile. Prior to signing the agreement, Chile already had an extensive network of FTAs. One motivation behind China seeking an FTA with Chile was to gain access to countries within Chile's network to avoid trade discrimination in the Americas.[58]

While Chile's largest imports from China are machinery and textiles, China's largest imports from Chile are base metals and minerals.[59] Under the agreement, China and Chile will eliminate 98 percent of tariffs by 2015 and reduce the overall average tariff from 6 percent in 2006 to 0.1 percent by 2015.[60] The two countries will also further strengthen exchange and cooperation in such areas as culture, education, science and technology, and environmental protection.[61]

Peru FTA

Signed in 2009, the China-Peru FTA is China's first comprehensive FTA with a Latin American country (meaning it includes tariff cuts and investment provisions), and reflects China's growing investments in Latin America's natural resources sector.[62] Peru is strategically important because it is one of the world's major suppliers of base metals, particularly copper.[63]

Similar to the New Zealand FTA, China only agreed to grant future MFN status, and Peru was not able compel China agree to broadened market access rules.[64] However, China did agree to accord fair and equitable treatment according to "customary international law," the first such incorporation of a Western standard for China's investment policy.[65]

Costa Rica FTA

Costa Rica is China's second-largest trading partner in Central America, while China is the second largest trading partner of Costa Rica. The FTA, which covers trade in goods and services, took effect on August 1, 2011, and all provisions will be fully implemented by 2025.[66] The FTA will gradually eliminate tariffs on over 90 percent of goods traded between both countries. Goods that will benefit from the agreement include China's textiles and related products, industrial products, machines, electrical equipment, vegetables, fruits, automobiles, chemical products, unprocessed fur products, and leather products. Costa Rica will benefit from tariff reduction on coffee, beef, pork, pineapple juice, frozen orange juice, jams, processed fish products, mineral products, and rawhide.[67]

In services trade, Costa Rica agreed to open an additional 45 sectors to China, including the telecommunications, education, and tourism sectors, while China agreed to open only seven additional services sectors to Costa Rica. [68]

Europe

Iceland FTA

The China-Iceland FTA, the first between China and a European country, was signed in April 2013. Iceland is one of the few European countries able to sign an FTA with China because it is not a member of the EU, which refuses to agree to Beijing's precondition that China be considered a market economy prior to engaging in FTA negotiations.[69] When China failed to make progress in negotiations with the EU, it considered negotiating an FTA with the European Free Trade Association (EFTA), but ultimately decided to conduct bilateral negations with each EFTA member, starting with Iceland. [70]

The volume of trade between the two countries is small. According to Chinese statistics, in 2014 Iceland's exports to China were $59 million (down from $75.8 million in 2013), and imports from China reached $143.7 million (down from $147 million in 2013). In 2013, China was Iceland's fourth largest source of imports, but only its 16th largest export market.[71] Through the FTA, Iceland hopes to benefit from a boost in exports to China.[72]

An agreement with Iceland is not expected to bring significant economic benefits to China, and many believe that China's real goal is better access to shipping routes through the Arctic.[73] In March 2013 a Chinese expert on polar policy predicted that by 2020 as much as 15 percent of China's trade would move through the Arctic's northern sea route.[74] The changing climate has opened the Arctic route and allowed for more traffic, while competition for access to the shipping routes has escalated. In May 2013 China was approved as a permanent observer of the Arctic Council, which required the backing of Iceland.[75]

China is not only interested in gaining access to the Arctic shipping routes, but also Arctic energy resources and space-research facilities.[76] In particular, China is interested in the geothermal industry in Iceland, as China hopes to expand domestic geothermal energy production.[77] While seafood exports have accounted for the largest share of China's imports from Iceland, other products such as ferrosilicon—which is used for steelmaking—are increasing.[78]

Switzerland FTA

China and Switzerland signed an FTA in July 2013 amid escalating tensions over the EU's investigation into dumping of Chinese solar panels (and China's retaliatory investigation into European wine).[79] After Iceland, it is China's second FTA with a European country. At entry into force in January 2014, tariffs on 99.7 percent of Chinese exports were abolished; in turn, China agreed to abolish tariffs on 84.2 percent of Swiss exports.[80] Switzerland is one of few European nations to run a trade surplus with China, driven by sales of luxury items and chemicals (according to Chinese statistics, the surplus reached $37 billion in 2014[*]). Switzerland, like Iceland, is

[*] China's customs data shows a widening deficit in goods with Switzerland, but this deficit does not show up in the Swiss customs data. For example, in 2013, over four-fifths of China's imports from Switzerland were in an obscure trade category that China's customs

not an EU member; it is part of the EFTA and has a bilateral agreement with the EU. For China, the FTA with Switzerland is an important step in economic diplomacy in Europe, as FTA negotiations with the EU stalled over the EU's unwillingness to recognize China as a market economy. [81]

Outlining China's FTA Strategy

No Official Policy

China does not publish an official FTA policy. It provides scarce information on ongoing negotiations, and does not oblige a government entity to inform the legislative branch (i.e., the National People's Congress) on the economic impact of a trade deal. This stands in contrast to the transparency of the U.S. government. U.S. objectives were written into law under Trade Promotion Authority until it expired in 2007.[*] Even in the absence of such legislation, the U.S. Commerce Department spells out its objectives in detail prior to and during negotiations, and regularly updates members of Congress through public hearings and private briefings. The U.S. International Trade Commission is also obliged to prepare an assessment of a trade agreement's impact on the U.S. economy before Congress decides to ratify it.[82]

MOFCOM vaguely states that "the Chinese government deems FTAs as a new platform to further opening up to the outside and speeding up domestic reforms, an effective approach to integrate into the global economy and strengthen economic cooperation with other economies, as well as an important supplement to the multilateral trading system."[83] References to domestic growth and job creation are conspicuously absent. The inclusion of the words "reform," "opening up," and "cooperation" in turn suggest that Beijing primarily seeks to reassure the outside world that its FTAs will boost domestic reform, rather than satisfy economic interest groups in its own ranks. The statement that FTAs "supplement" the WTO suggests that China is keen on maintaining a good reputation in the WTO.

In the absence of an official and detailed FTA policy, analysts are left to surmise China's true objectives. In terms of economic self-interest, it seems plausible that China would use trade agreements to boost exports, which create jobs and contribute to economic growth. Although not always successful, the United States—which is less export-oriented than China—has used its FTAs for this purpose. On the import side, one might expect China to maximize protection of vulnerable industries, such as agriculture and services, or to make such liberalization contingent upon a "quid pro quo" with the partner country. It is tempting to group China in the "defensive" school of preferential trading—alongside large and developing economies like Brazil and India[†] that are reluctant to open their borders through preferential trade. They stand opposed to the "offensive-minded" countries that either want genuine liberalization (e.g., the United States and EU) or are forced by their small market size to pursue trade agreements in order to remain competitive (e.g., Singapore and Chile).

In practice, China does not always conform to these assumptions. The rest of this section outlines the ways in which China selects partners and negotiates agreements. Section 3 considers some of its rationales for doing so.

Partner Selection

China's trade agreement partners account for one-third of China's total exports. As recently as 2008, China recorded a trade deficit with ASEAN of $2.9 billion; yet since the ACFTA came into full force in 2010, the balance has reversed, with China recording a trade surplus of $44.7 billion in 2013 (see Table 3). The only

officials call "commodities not classified." This could be due to over-invoicing of import receipts by Chinese companies and individuals looking to evade China's capital controls and funnel money out of the country.

[*] For more on Trade Promotion Authority, see Ian F. Fergusson, "Trade Promotion Authority (TPA) and the Role of Congress in Trade Policy," *Congressional Research Service*, April 27, 2015.

[†] India has, however, signed trade agreements with many of its South and Central Asian neighbors, as well as with ASEAN, Japan, and South Korea. Like China, it is now pursuing advanced economies. Reports emerged in November 2013, soon after China's FTAs with Iceland and Switzerland, that India, too, was seeking an FTA with the EFTA countries. Indian Ministry of Commerce and Industry. *http://commerce.nic.in/trade/international_ta.asp*; Press Trust of India, "EFTA Nations in Talks with India for Free Trade Agreement," November 11, 2013, via Factiva.

country in the ASEAN bloc with which China has a rising deficit is Malaysia, presumably because it supplies China with manufacturing components. An export-oriented mindset would also explain China's interest in a trade agreement with India, with which it had a $36 billion trade surplus in 2014. Signing trade agreements with resource-exporting countries cements a "resources-for-manufactures" pattern of trade at little cost and much benefit to China's domestic industry.

Table 3. China's Goods Trade with ASEAN

	Trade balance (US$ millions)			Total trade				
				US$ millions			Compound annual growth (%)	
US$ millions	2003	2008	2013	2003	2008	2013	2003-08	2008-13
ASEAN Total	**(16,415)**	**(2,873)**	**44,731**	**78,285**	**231,151**	**292,760**	24.2%	4.8%
Brunei	(277)	47	1,617	345	212	1,007	-9.2%	36.5%
Cambodia	268	1,056	3,050	321	1,134	1,442	28.7%	4.9%
Indonesia	(1,272)	2,823	5,469	10,236	31,597	42,738	25.3%	6.2%
Laos	87	119	701	109	418	1,044	30.7%	20.1%
Malaysia	(7,856)	(10,748)	(14,128)	20,141	53,514	74,216	21.6%	6.8%
Myanmar	738	1,335	4,540	1,077	2,624	4,444	19.5%	11.1%
Philippines	(3,215)	(10,420)	1,631	9,404	28,596	27,764	24.9%	-0.6%
Singapore	(1,613)	12,233	15,918	19,360	52,417	57,053	22.0%	1.7%
Thailand	(5,000)	(10,116)	(5,780)	12,658	41,157	52,960	26.6%	5.2%
Vietnam	1,725	10,797	31,714	4,635	19,482	30,092	33.3%	9.1%

Source: China's General Administration of Customs, via CEIC.

Nonetheless, the aggregate benefits of current trade agreement deals for Chinese exporters seem limited. While Hong Kong and ASEAN account for the bulk of China's exports, China has trade deficits with most of its partners. When Hong Kong is subtracted from the equation, trade agreement partners in force accounted for 27.8 percent of China's imports but only 17 percent of its exports in 2014 (see Table 4). The trade agreement partners under negotiation likewise comprise a larger share of China's imports than its exports. Most striking are South Korea, Japan, and Taiwan: China's cumulative trade deficit with these countries increased from $78 billion in 2003 to $209.5 billion in 2014. That is a mirror image of China's positive trade balance with the EU and the United States, its top trading partners. (One caveat is that China's customs data—particularly with Taiwan—inflates the actual value of China's imports.[*])

Aside from the fact that China has trade deficits with many of its partners, it is also targeting countries that have comparative advantages in industries that could hurt Chinese producers. Singapore, Taiwan, Hong Kong, and Switzerland are very strong in services trade. China also has or is negotiating trade agreements with 11 of the 21 members of the Cairns Group, a coalition of agricultural exporting countries with a commitment to reforming agricultural trade. The United States, which has a much more open agriculture sector, only has six FTAs in force with Cairns Group members (with three FTAs under negotiation).

[*] The actual deficits with these countries are disputable, since China's customs data tends not to match up with that of its trade partners. For example, China's customs officials recorded a deficit with Taiwan of $116 billion in 2013, whereas Taiwan's customs officials recorded a trade surplus with China of only $39 billion.

Table 4. China's Goods Trade with Select Partners, 2003–2014

	Imports			Exports			Total		
	2003	2008	2014	2003	2008	2014	2003	2008	2014
World (US$ bn)	**$413**	**$1,132**	**$1,963**	**$438**	**$1,429**	**$2,343**	**$852**	**$2,561**	**$4,306**
FTA Partners in force	*29.83%*	*26.37%*	*28.45%*	*29.44%*	*26.43%*	*32.67%*	*29.63%*	*26.40%*	*30.75%*
ASEAN	11.46%	10.34%	10.62%	7.06%	7.99%	11.60%	9.19%	9.03%	11.16%
Australia	1.77%	3.21%	5.00%	1.43%	1.56%	1.67%	1.59%	2.29%	3.19%
Chile	0.54%	1.00%	1.08%	0.29%	0.43%	0.56%	0.41%	0.68%	0.79%
Costa Rica	0.14%	0.20%	0.21%	0.02%	0.04%	0.05%	0.08%	0.11%	0.12%
Hong Kong	2.70%	1.14%	0.66%	17.41%	13.35%	15.50%	10.27%	7.95%	8.73%
Iceland	0.01%	0.00%	0.00%	0.01%	0.01%	0.01%	0.01%	0.01%	0.00%
Macau	0.04%	0.03%	0.01%	0.29%	0.18%	0.15%	0.17%	0.11%	0.09%
New Zealand	0.25%	0.17%	0.48%	0.18%	0.18%	0.20%	0.21%	0.17%	0.33%
Pakistan	0.14%	0.09%	0.14%	0.42%	0.42%	0.57%	0.29%	0.27%	0.37%
Peru	0.18%	0.41%	0.42%	0.08%	0.19%	0.26%	0.13%	0.29%	0.33%
Switzerland	0.65%	0.65%	2.06%	0.19%	0.27%	0.13%	0.41%	0.44%	1.01%
Taiwan	11.95%	9.13%	7.76%	2.06%	1.81%	1.98%	6.86%	5.05%	4.61%
FTA Partners under negotiation	*30.76%*	*28.18%*	*23.68%*	*20.19%*	*16.18%*	*13.72%*	*25.32%*	*21.48%*	*18.26%*
Korea	10.45%	9.91%	9.70%	4.59%	5.17%	4.29%	7.43%	7.27%	6.75%
Japan	17.96%	13.32%	8.31%	13.56%	8.13%	6.39%	15.70%	10.42%	7.26%
Norway	0.21%	0.19%	0.23%	0.21%	0.18%	0.12%	0.21%	0.18%	0.17%
GCC	2.14%	4.76%	5.44%	1.85%	2.70%	2.93%	1.99%	3.61%	4.07%
China's Largest Trade Partners	*21.06%*	*18.94%*	*20.56%*	*37.54%*	*38.15%*	*32.74%*	*29.54%*	*29.66%*	*27.19%*
United States	8.20%	7.20%	8.11%	21.10%	17.66%	16.91%	14.84%	13.03%	12.90%
EU	12.86%	11.74%	12.45%	16.44%	20.50%	15.83%	14.70%	16.63%	14.29%
Rest of World	*18.36%*	*26.51%*	*27.31%*	*12.83%*	*19.24%*	*20.87%*	*15.51%*	*22.45%*	*23.81%*

Source: China's General Administration of Customs, via CEIC.

Negotiating Strategy

Mixing Generosity and Protectionism

Basic economic self-interest—boosting exports and protecting domestic industries—is not the only motive behind China's selection of preferential trade partners. The same can be said for the way it negotiates agreements. More so than the United States, China has been willing to make concessions in certain agreements, sometimes for overt political reasons. For example, it opened its market unilaterally to Hong Kong and Macau, since those territories were already duty-free zones at the time the CEPAs were signed.[84] More striking is that, under the ECFA "early harvest" agreement, China cut tariffs on twice as many import items as Taiwan, amounting to five times the monetary value of Taiwan's concessions (see Table 5).

Table 5. Bilateral Concessions on Goods in the China-Taiwan ECFA "Early Harvest"

	China	Taiwan
Items	539	267
Value (US$ billion)	$138.4	$ 28.6
Share (%) of bilateral imports	16.1%	10.5%

Source: Adapted from Pasha Hsieh, "China-Taiwan ECFA, Geopolitical Dimensions and WTO Law," *Journal of International Economic Law* 14:1 (2011): 143.

The scholar Hidetaka Yoshimatsu notes that China and Japan took inverse approaches to negotiating trade agreements with ASEAN. China was willing to sit down with all ten ASEAN members from the outset. Its one bilateral FTA with an ASEAN member, Singapore, occurred after the ACFTA was completed. China also allowed ASEAN countries to establish individual tariff schedules within the free trade area, signed a special agriculture deal with Thailand, and permitted an eight-year early harvest period. During ASEAN-Japan Comprehensive Economic Partnership (AJCEP) negotiations, Japan took a "divide and conquer" approach instead. It signed bilateral FTAs with seven out of ten ASEAN members before completing the AJCEP to counteract the collective bargaining leverage of ASEAN. China used the "number of imported items" measure as the base for calculating its reduction of import tariffs; Japan used only the "value of imports" as the base, allowing it to exclude several agricultural products.[85]

Agriculture is a prime candidate for protection—for example, the United States, Japan, and Europe have avoided giving ground on certain agricultural imports in the TPP and TTIP talks.[86] China has not only signed agreements with several agriculture exporters but has also taken steps to liberalize farm goods trade in the face of domestic opposition. Implementation of the ASEAN early harvest agreement led to a substantial increase in ASEAN countries' exports of fruits and vegetables to the Chinese market, hurting tropical fruit producers in China's southern and southwestern provinces. China also increased its farm goods imports from Taiwan under the ECFA. In negotiations with New Zealand, Chinese negotiators were less amenable to agricultural trade liberalization than in the ASEAN talks, arguing that New Zealand's meat and dairy exports could adversely affect Chinese farmers already struggling to cope with WTO demands. Nonetheless, China eventually lowered duties on several farm goods, which have increased significantly as a share of Chinese imports from New Zealand.[87]

One might expect China to apply measures "at the border," such as strict rules of origin (ROO)[*] and long tariff phase-ins. Yet, China's tariff reductions frequently exceed the 90 percent level that is common for FTAs worldwide.[88] In the ASEAN agreement, which accounts for the largest share of China's preferential imports, 92 percent of tariff lines in 2011 were duty-free. Under ROO, which determine what percentage of content must be sourced from the trade agreement partner to qualify for preferential tariffs, China has also been fairly generous. Products with a minimum of 40 percent "regional value content" generally qualify for preferential tariffs. Where China adopts stricter ROO standards (e.g., a combination of change in tariff classification, value-added, and processing), it is at the behest of advanced economies such as Switzerland and New Zealand. A clause in the China-Switzerland agreement also provides for negotiation every two years to improve market access.[89]

The inclination to lower tariffs is remarkable considering the trenchant cuts China committed to in the WTO. Fifty-four percent of China's goods imports were MFN duty-free in 2011, compared to 30 percent in Brazil and 14 percent in India. (The U.S. level was also lower, at 50.5 percent.) China's final bound tariff rate—the

[*] ROO are the criteria needed to determine the national source of a product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports. Generous ROO confer preferential tariffs when only a small percentage of an imported good is produced in the exporting country (or other countries within a common trading bloc). Narrow ROO require most or all of the content to originate in the exporting country (or other countries within a common trading bloc). According to the WTO: "There is wide variation in the practice of governments with regard to the ROO. While the requirement of substantial transformation is universally recognized, some governments apply the criterion of change of tariff classification, others the ad valorem percentage criterion and yet others the criterion of manufacturing or processing operation. In a globalizing world it has become even more important that a degree of harmonization is achieved in these practices of Members in implementing such a requirement." World Trade Organization, "Technical Information on Rules of Origin." *http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm*.

maximum rate it is permitted to apply—is 10 percent for all goods and 15.8 percent for agricultural goods—well below Brazil, India, and Mexico. Its "binding overhang"—the difference between applied and bound tariff rates—is less than one percent, giving it minimal leeway to raise tariffs without violating WTO commitments. Other developing countries have binding overhangs in the double digits (e.g., India's is 79.6 percent for agriculture tariffs).[90]

There are limits to China's free trade stance, however. U.S. agreements tend to cover more product categories and are negotiated from the start with as comprehensive a list as possible. China prefers to start with a much narrower list, and expands it if necessary. In individual industries, China allows only limited access. In the agriculture sector, for example, Beijing's selective market opening is offset by its extreme protection of grain and meat products. Rising incomes and urbanization are increasing demand in China for high-quality protein, but the Chinese government uses unscientific sanitary and phytosanitary (SPS) standards[*] to slow imports of meat products, in violation of its WTO commitments. A self-sufficiency mandate preempts imports of wheat, rice, and corn beyond a certain level.[†] Not surprisingly, the ASEAN goods agreement excludes rice and corn. The exception to China's grain mandate is soybeans, which are an indispensable feedstock for China's outsized pork, poultry, and farm-raised fish industries.

China has taken steps to protect manufacturing industries as well. Swiss exporters were disappointed with the China-Switzerland FTA, for instance. Forty-four percent of the volume of Swiss machine tools did not benefit from any tariff exemption.[91] China agreed to lower tariffs on 99 percent of textile imports from Switzerland, but these only account for 1.3 percent of the Swiss goods entering China. For the goods that comprise three-quarters of Swiss exports to China—mechanical and electrical industries (30 percent of exports), chemical and pharmaceutical industries (24 percent), and precision instruments, watch making and jewelry (21 percent)—the share of products benefiting from tariff exemptions range from just 64 to 78 percent.[92] The watch maker Swatch was touted as the prime benefactor of the bilateral deal; yet the impact on the company's bottom line is likely to be minimal. The 60-percent cut on luxury watch duties is subject to a ten-year phase-in period, and China imposes steep import and luxury taxes on watches beyond the import duty itself. According to one calculation, even by the time all the cuts are factored in, total taxation on high-end Swiss watches will be 24.4 percent.[93]

China's stiffest test is yet to come, as it pursues deals with Northeast Asian countries that are strong in manufacturing. An FTA with South Korea and Japan could force China to lower its hefty tariff and non-tariff barriers in the automotive sector.[‡] China has been reluctant to liberalize information technology products under the WTO Information Technology Agreement (ITA). Eleven of China's current and prospective trade agreement partners—including Taiwan, South Korea, and Japan—are part of the plurilateral ITA, which implies that China is not offering these countries much better deals on a preferential basis. Although China made generous concessions in its early harvest deal with Taiwan, some domestic industries pushed back—for example, the 88 petrochemical products included in the early harvest account for only 10 percent of the petrochemical items that Taiwan initially requested. According to one scholar, Chinese state-owned petrochemical enterprises opposed

[*] For the purposes of the WTO SPS Agreement, sanitary and phytosanitary measures are defined as any measures applied to protect human or animal life from risks arising from additives, contaminants, toxins, or disease-causing organisms in their food. According to the WTO: "The SPS Agreement, while permitting governments to maintain appropriate sanitary and phytosanitary protection, reduces possible arbitrariness of decisions and encourages consistent decision-making. It requires that sanitary and phytosanitary measures be applied for no other purpose than that of ensuring food safety and animal and plant health. In particular, the agreement clarifies which factors should be taken into account in the assessment of the risk involved. Measures to ensure food safety and to protect the health of animals and plants should be based as far as possible on the analysis and assessment of objective and accurate scientific data." World Trade Organization, "Understanding the WTO Agreement on Sanitary and Phytosanitary Measures." *http://www.wto.org/english/tratop_e/sps_e/spsund_e.htm*.

[†] For more on China's agriculture policy, see U.S.-China Economic and Security Review Commission, *2013 Annual Report to Congress*, November 2013, 153–193.

[‡] China maintains a tariff duty of 25 percent on auto imports, compared to 5 percent in the United States. Taking into account the 17 percent value-added tax and other levies, imported cars are more expensive than the same cars in the United States. Duties and related levies have served as an effective means for China to compel foreign car makers to relocate production to China. Baizhu Chen, "Tear Down This Wall – The Chinese Tariff Wall," *Forbes*, July 12, 2012. *http://www.forbes.com/sites/baizhuchen/2012/07/12/tear-down-this-wall-the-chinese-tariff-wall/*. For more information, see also Iacob Koch-Weser, "China's Hunger for U.S. Planes and Cars: Assessing the Risks," *U.S.-China Economic and Security Review Commission*, March 2014. *http://origin.www.uscc.gov/sites/default/files/Research/USCC%20Economic%20Issue%20Brief_ChinasHunger_03.27.14.pdf*.

opening this segment to competition from Taiwan competition, particularly to Taiwan's competitive polyvinyl chloride producers.[94]

A Haphazard Approach to Higher Standards

Compared to U.S. FTAs, China's contain few advanced provisions. China generally opts either to (a) repeat the same commitments it has already made in its WTO accession agreement; (b) completely exclude certain advanced provisions; or (c) restrict advanced provisions to certain sectors, by avoiding detailed legal language or placing them in a separate document, such as a memorandum of understanding.[95] It is even rarer for China to pursue "WTO-plus" and "WTO-extra" provisions that would advance global trade rules beyond the WTO Uruguay Round. Areas where China's agreements fall short include:

- *Ownership restrictions.* China publishes a Foreign Investment Catalogue that restricts foreign investors to joint ventures in many industries. These restrictions are written into China's General Agreement on Trade and Services (GATS) commitments in the WTO. China has only made piecemeal concessions in its FTAs to raise levels of foreign ownership. For example, Swiss companies in environmental services and certain insurance companies are now permitted to set up wholly foreign-owned enterprises where GATS only allows joint ventures.[96]
- *Positive lists and exception clauses.* China does not consistently use a negative list to clarify which sectors of its economy are off limits or restricted to foreign trade and investment. It prefers "positive lists" that spell out the permitted sectors, creating uncertainty about the status of sectors not on the list. China also dilutes foreign companies' rights by insisting on vague exception clauses, such as the protection of "essential security interests."[97] China is also reluctant to open its domestic resources to outsiders. Investment in mining and farming, for example, is practically off limits, which is of particular concern to Australia and the United States.[*]
- *Limited market access and non-discrimination.* China agrees to accord all foreign investors equal market access (MFN status) but not the same market access as domestic investors ("national treatment"). China has agreed to treat foreign investors the same as domestic investors in like circumstances, but only after they set up their operation in China. This "post-establishment national treatment" provision is also subject to a grandfather clause[†] for non-conforming measures. China has only granted Pakistan and ASEAN full national treatment—all other partners are only treated in accordance with "customary international law."
- *Government procurement.* China has the world's largest government procurement market but has done little to open it to private Chinese and foreign companies. Washington demands non-discrimination, transparency, and predictability, and a commitment to opening up procurement with "comparable levels" of coverage by all TPP countries. China has failed to meet its 2001 pledge to join the WTO Agreement on Government Procurement (GPA) "as soon as possible"—its latest offer was rejected in 2014, largely because China was unwilling to include the lucrative procurement contracts given out by subnational governments.
- *Performance requirements.* Clauses exempting investors from performance requirements—such as sourcing local labor and inputs—are only included in the New Zealand FTA and China's investment treaty with Canada.[98]

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[*] Australia has tried to gain access to China's mining industry, which according to the Minerals Council of Australia presents numerous restrictions in terms of ownership, access to geological data, as well as lack of transparency of regulations and legal processes. Mining is not listed as a sector for which China has liberalized investment; foreign companies only have the right to explore resources in China but not claim or own them because they are regarded by the Chinese government as "national assets." Behind this apparent national security imperative lies the fact that the profits accruing from the mining industry in China have been too lucrative for the Chinese authorities to subject it to foreign competition. Yang Jiang, "China's Pursuit of Free Trade Agreements: Is China Exceptional?" *Review of International Political Economy* 17:2 (May 2010): 246.

[†] A grandfather clause is a provision in which an old rule continues to apply to some existing situations while a new rule will apply to all future cases. Those exempt from the new rule are said to have grandfather rights or acquired rights.

- *Restricted transfers of capital, personnel, and data.* China's agreements do not permit the free transfer of investment capital in and out of the country. These restrictions abuse the internationally prevalent "transfer clause," under which a government is permitted to restrict investment flows in the event of serious balance-of-payments or other macroeconomic difficulties. China has not signed on to provisions on the free transfer of data across borders, instead requiring foreign companies to maintain data servers in China.[99] China has also made little effort to liberalize work permits for foreigners beyond the basic conventions spelled out in GATS. The China-Switzerland FTA takes a piecemeal approach, granting contractual service suppliers, such as installers and maintainers, architects and engineers, a stay permit of up to six months or one year according to the FTA schedule[100]
- *Intellectual property.* China's FTAs contain virtually no commitments beyond what China agreed to under WTO's Agreement on Trade-Related Aspects of Intellectual Property (TRIPS)[*] on issues such as data exclusivity, digital copyright laws, and special provisions for counterfeit food and drug products that harm public health. The China-Switzerland FTA makes minor progress on enforcement.[†]
- *Labor and the environment.* Labor and environmental standards get little attention in China's FTAs. Most often, the parties reaffirm commitments made in multilateral agreements. Of all China's FTAs, only the agreement with Switzerland has an independent environmental issues chapter.[101] China has not adopted any of the International Labor Organization (ILO) standards, some of which conflict directly with China's restrictions on unionization of labor. The "May 10 agreement," which forms the basis of the U.S. template on labor and environment issues, stipulates that lack of institutional capacity is no defense against implementation of labor and environment standards in disputes.[102]

China's agreements are not only narrow in scope, but also lack the strength that comes with detailed language on dispute settlement. FTAs handle disputes at a high level, since national governments may be involved in bringing forward complaints. This makes adequate dispute settlement mechanisms vital. A comparison of the fine print in Chinese and U.S. FTAs with Peru and Chile illustrates important discrepancies in the two countries' approaches. While China adheres to some of the same basic standardized clauses,[‡] it departs from the terms in other key clauses:

- Under the U.S. rules of procedures, panel hearings are to be open to the public, as are the written submissions of each party to the panel. This is not the case for China, where there is no obligation to go public prior to the final report of the panel.[103]
- The U.S. version strongly encourages consultation with civil society, and panelists may seek outside advice from private actors, "including information concerning environmental, labor, health, safety, or other technical matters." No such explicit references are made in the Chinese FTAs.[104]

[*] The Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) is a WTO-administered agreement which sets down the minimum standards for different forms of intellectual property protection and regulation. Protections that go beyond TRIPS standards are called "TRIPS-plus." For a primer on TRIPS, see WTO, "Intellectual Property: Protection and Enforcement." *https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm*.

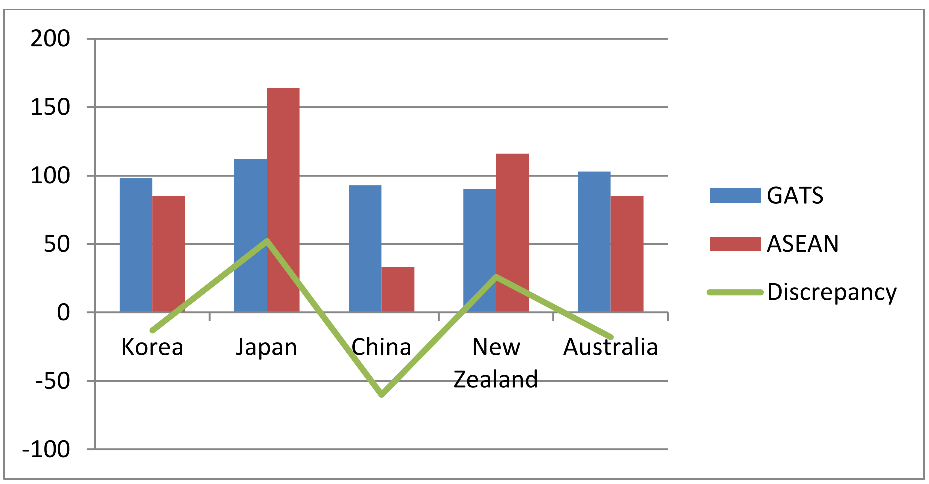
[†] Regarding enforcement, the China-Switzerland FTA provides that the amount of damages caused by a violation of intellectual property (IP) rights shall be determined in consideration of actual damages or a fair license fee. The possibility of using fair license fees for the calculation of damages is mentioned in China's patent and trademark laws, but not in China's Copyright Law. FTA wording is strong on provisional measures and injunctions: The parties to the FTA must ensure that their judicial authorities may order prompt and effective provisional measures to prevent infringement to IP rights from occurring, including ex parte measures, where any delay is likely to cause irreparable damage to the right holder. The FTA is also detailed compared to general rules of property preservation of China's Civil Procedure Law. Wenfei Law, "A Practical Guide to the New Free-Trade Agreement between Switzerland and China," December 2013, 10–11. *http://www.wenfei.com/fileadmin/pdfs/China_Publications/Wenfei_FTA_Publication_December_2013.pdf*.

[‡] Both the U.S. and Chinese FTAs with Peru and Chile contain the same basic guidelines as to how to resolve disputes when they arise. Either party can bring a complaint, which they try to address through consultations. If that fails, a three-member panel adjudicates the dispute, with each country picking one panel member and agreeing on a third. The panel publishes an initial report that can then be read and commented on for revisions. A final report is published—and made available to the public after a given period—issuing recommendations for how to resolve the dispute. Those recommendations can then become binding, so that the defendant party must implement the recommendations.

- The U.S. version requires the panel to make the final report open to the public within 15 days of its release. The Chinese version has an extra clause that relaxes the time constraint on when the panel needs to release the initial report.[105]
- The U.S. version codifies tough rules for material compensation if the defendant does not follow through on the panel's recommendations.[*] The Chinese FTA merely refers to "mutually acceptable compensation."[106]

In signing lower-standard agreements, China has also made use of loopholes in the WTO system. In the 1990s, FTAs were not yet the norm, especially in Asia. If China had pursued preferential trade during its WTO accession talks in the 1990s, it would have cast doubt on its commitment to multilateral trade. Other WTO members also could have used the more generous offers China tabled in a preferential agreement as a benchmark to measure its WTO commitments. On paper, the WTO obligates all of its members to report their FTAs to the WTO Committee on Regional Trade Agreements (CRTA). FTAs are permitted under Article XXIV of the General Agreement on Tariffs and Trade (GATT) (for goods) and Article V of GATS (for services). The precondition is that the signatories commit to liberalizing "substantially all trade" in goods and "substantially all sectors" of services. Some WTO members—like the EU and Japan—have written lengthy justifications for why their FTAs promote free trade, but increasingly, other countries (particularly in Asia) have refrained from doing so. The CRTA, however, has lacked the resources and member support to oversee and enforce the relevant provisions properly. Just as China has found ways to circumvent other WTO obligations, it made use of this loophole to sign low-standard FTAs that do not qualify under GATT XXIV and GATS V. For example, it opened far fewer services sectors to ASEAN members than it did under GATS (see Figure 1).

Figure 1. Services Sectors Liberalized to ASEAN Members by Select Countries



Source: WTO; He Ping and Shen Chen, "RCEP and China's Asia Pacific FTA Strategy," *International Issues Research* 3 (2013): 51 [Staff translation].

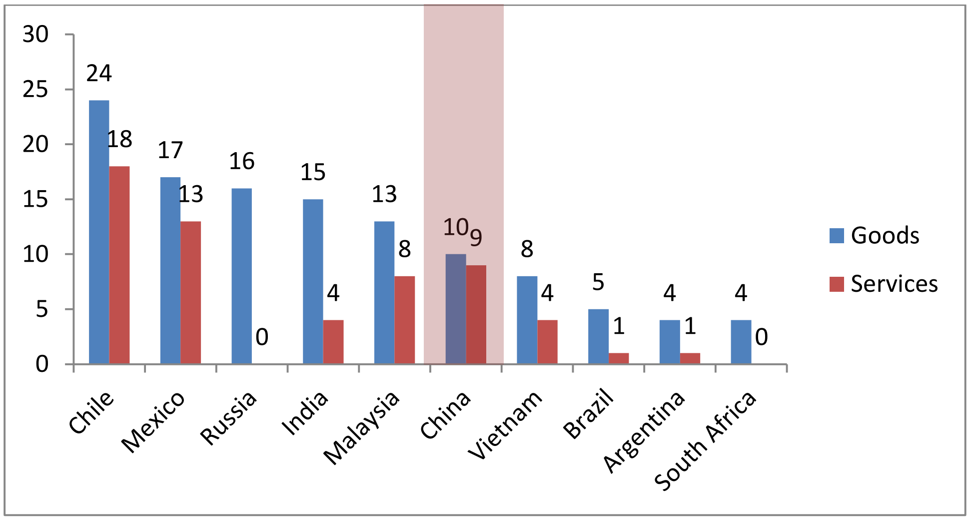
Although China has been content with lower-standard trade agreements, calling its strategy "defensive" is too simple. China has done considerably more to pursue advanced provisions than other large developing countries. For instance, while India consistently uses the WTO's "enabling clause"[†] to make lower-standard FTAs with

[*] The U.S. FTAs with Chile and Peru both state: "The disputing Parties shall consult, beginning no later than 10 days after the Party complained against provides notice, with a view to reaching agreement on the amount of the assessment. If the Parties are unable to reach an agreement within 30 days after consultations begin, the amount of the assessment shall be set at a level, in U.S. dollars, equal to 50% of the level of the benefits the panel has determined under paragraph 3 to be of equivalent effect or, if the panel has not determined the level, 50% of the level that the complaining Party has proposed to suspend under paragraph 2." Office of the United States Trade Representative, "The United States - Peru Trade Promotion Agreement: Chapter Twenty-One: Dispute Settlement", 10. *https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file144_9539.pdf*.

[†] The enabling clause, adopted during the WTO Tokyo Round, permits trading preferences targeted at developing and least developed countries which would otherwise violate Article I of the GATT. It allows developed countries to give preferential treatment to poorer

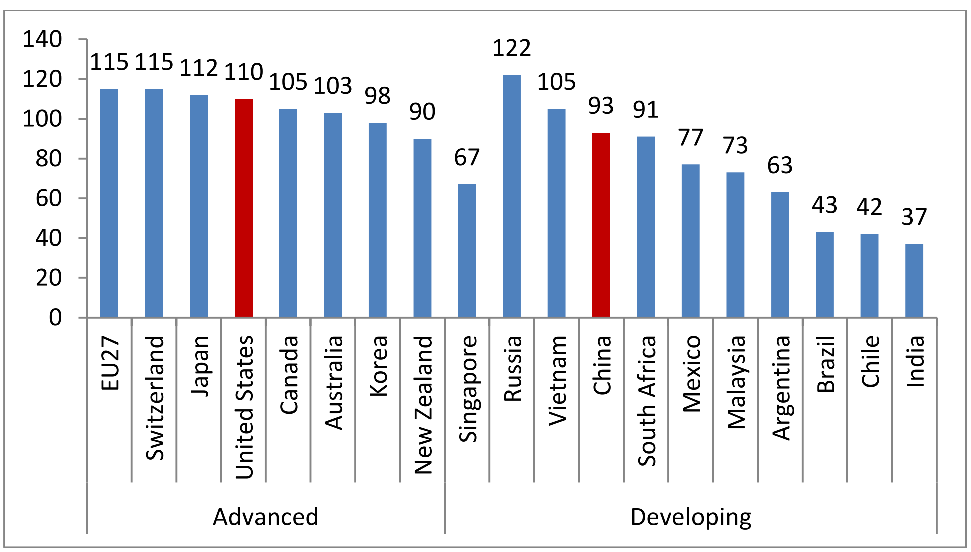
developing countries WTO-consistent, China has used this clause only once (with ASEAN).[107] As Figure 2 shows, the world's large developing countries tend to sign far more preferential agreements on goods than services. India has reported 15 goods and four services agreements to WTO; for Russia, the ratio is 16 to 0. China's ratio is a respectable 10-to-9: At least on paper, China is seeking commitments beyond goods. Already in its WTO accession protocol, China committed 93 of its services sectors to GATS, not far behind the United States, and about three times India's level (see Figure 3).

Figure 2. Goods and Services FTAs among Select Developing Countries



Source: WTO country profiles.

Figure 3. Services Sectors Covered by WTO GATS in Major Advanced and Developing Economies



Source: WTO country profiles.

Other aspects of China's FTAs also indicate greater ambition. The CEPA opened many service sectors earlier or more widely to Hong Kong companies and individuals than to WTO members. In the services agreement being

countries, particularly to least developed countries. It allows developing countries to enter into agreements which may be non-reciprocal, or cover a very limited range of products (which would otherwise contravene the GATT).

negotiated with Taiwan, for example, China would liberalize 80 services industries to Taiwan's 64.* Furthermore, although China has watered down dispute settlement mechanisms, its more recent investment treaties provide for full investor-state dispute settlement that allows foreign courts to adjudicate disputes.[108] Many developing countries are uncomfortable with investor-state dispute settlement provisions, arguing that they impinge on national sovereignty.

Rather than offensive or defensive, China's approach to higher standards is best described as haphazard. According to political scientists John Ravenhill and Yang Jiang, China sometimes takes the initiative in launching FTA talks, but in other cases responds to the request of other countries (see Table 6).[109] Beijing does not appear overly concerned with efficiency either: A 2008 study showed that it had engaged in FTA talks with dozens of counterparts—including Brazil and the Shanghai Cooperation Organization—most of which never materialized.[110] (In the case of Australia, bilateral talks concluded only recently, having dragged on for over a decade.) Furthermore, where the United States exercises leadership by tabling a standard template, China prefers to work off the draft provisions of the other party, even if it is a marginal country like Peru or Pakistan.[111] That may explain why the quality of China's agreements runs the gamut from a very low standard with Pakistan and ASEAN to a fairly high standard with New Zealand and Switzerland.

China also varies the sequencing of agreements. Four of its FTAs use the "step-by-step" model based on the "ASEAN framework," where agreements on goods precede investment and services, and the first step is an "early harvest" that liberalizes a subset of products. Eight of China's FTAs, on the other hand, adhere to the "single undertaking" approach preferred by the United States, by which all provisions are merged into one agreement.

Table 6. Who Initiated China's FTA Talks?

Completed		*Under negotiation*	
Partner	Did China initiate?	Partner	Did China initiate?
ASEAN	Y	GCC	Y
Australia	N	Norway	N
Chile	Y	South Korea	Y
Costa Rica	na	Japan and Korea	Y
Hong Kong	N		
Iceland	N		
Macau	N		
New Zealand	N		
Pakistan	na		
Singapore	N		
Switzerland	N		

Source: Adapted from John Ravenhill and Yang Jiang, "China's Move to Preferential Trading: A New Direction in China's Diplomacy," *Journal of Contemporary China* 18:58 (January 2009): 29.

China's approach to investment provisions is also unorthodox. According to the United Nations, China has signed over 130 BITs (with nearly as many countries), ranking second worldwide behind Germany. Few developing countries come close to that number. The United States has signed only 46 BITs, and just three over the past decade.[112] One cause of this disparity is that the United States prefers to incorporate provisions into the investment chapters of FTAs, and resorts to a standalone investment treaty only when it is absolutely necessary and high standards are met. China, on the other hand, signed a flurry of low-standard BITs beginning in the 1980s and 1990s—decades ahead of its preferential trade deals—to deepen economic cooperation and reassure foreign investors. Only six of China's FTAs also include comprehensive rules on investment. How China incorporates

* Affected industries include business services, communication services, construction and related engineering services, distribution services, environmental services, health-related and social services, tourism and travel-related services, recreational, cultural, and sporting services, transport services, and financial services.

BIT provisions into its FTAs seems to vary. In the cases of Costa Rica and Switzerland, China signed investment treaties just prior to the FTA, so that the relevant provisions were effectively reiterated in the trade deal.[*] China might do the same in the future with South Korea, Mexico, Canada, and India, with whom it signed BITs fairly recently. However, for those BITs predating the 2000s, China's negotiating partners are likely to seek the renegotiation of investment conditions, either in a BIT or in the FTA itself. As alluded to earlier, China has also been inconsistent across its investment agreements, offering different partners different benefits.

Unusual as well is China's approach to WTO plurilateral agreements on services and procurement. Rather than refuse participation in these agreements outright, as most developing countries have done, China has made ambivalent efforts to join them. In its WTO accession agreement, it pledged to accede to the GPA "as soon as possible," but has since submitted one unsatisfactory offer after another. China is also one of the few emerging markets that has expressed interest in joining the Trade in Services Agreement (TISA) talks launched in 2013. It has not been granted permission to do so by the other negotiating parties, who worry that China's cosseted services sector and unproductive approach to WTO negotiations will slow down progress on the agreement.[†]

Key Factors Influencing Chinese Policy

Diverse factors inform China's approach to preferential trade. This section covers economic, strategic, and institutional variables. It also considers whether and how China's preferences are shifting due to internal and external forces.

Economic and Institutional Factors

Limited Institutional Capacity

Before discussing China's objectives, it is important to distinguish willingness from capacity. China may be the world's second-largest economy, with a vast government and Party apparatus, but the quality of its bureaucracy does not match that of the United States or other advanced economies. Owing to reforms in the 1990s, China's administrative structure is decentralized, resulting in small agencies at the central level and uneven implementation of central directives by the larger bureaucracies at the provincial and municipal level. MOFCOM, the agency that represents China in trade negotiations, is understaffed and lacks authority over Party organs and other government agencies. According to one scholar, MOFCOM also maintains separate departments for preferential trade and WTO matters that scarcely coordinate with each other.[113] In addition, China's relatively short history of international trade and WTO membership has given its trade negotiators limited time to gain experience.

Limited institutional capacity impacts China's preferential trade in several ways. First, in the years before and immediately after WTO accession, China's trade officials were preoccupied with negotiating and enforcing the accession protocol, which left little time for other trade initiatives. Second, China has targeted smaller countries because its negotiators can use their leverage to compensate for inexperience, exert pressure where needed, and contain the damage of mistakes. Dozens of negotiating rounds—with countries well-versed in trade bargaining—have allowed Chinese officials to hone their skills for future engagement with larger countries.[114] Third, getting China to agree to higher-standard commitments does not guarantee that those commitments will be properly

[*] The provisions relating to investment promotion supplement the Switzerland-China BIT, which came into force in April 2010. As the BIT remains in force unchanged, the provisions of the FTA are confined to investment promotion. Article 9.1 of the FTA holds that the two countries are committed to "promoting mutual cross-border investment and technology flows", but stops short of setting any clear and binding guidelines. Wenfei Law, "A Practical Guide to the New Free-Trade Agreement between Switzerland and China," December 2013, 13–14. *http://www.wenfei.com/fileadmin/pdfs/China_Publications/Wenfei_FTA_Publication_December_2013.pdf*.

[†] For more information, see Iacob Koch-Weser, "Should China Join the WTO Services Agreement?" *U.S.-China Economic and Security Review Commission*, March 2014. *http://www.uscc.gov/Research/should-china-join-wto%E2%80%99s-services-agreement*.

enforced. Issues like intellectual property theft* or faulty customs procedures are exacerbated by corruption and bribery among local officials, and the balkanized structure of the country's regulatory bodies.

Lastly, for all the talk of FTAs facilitating regional trade networks, surveys show that exporters in China make little use of the preferences the government negotiates on their behalf.[115] The companies that stand to benefit, typically small and medium-sized enterprises in China's manufacturing hubs, are not even cognizant of the agreements. If they are, they may find it too time consuming and costly to file the paperwork necessary to prove rules of origin. For the most part, they have been content to use WTO MFN tariff rates, which are already quite low in many industries. Comparative advantages—such as cheap energy inputs, an undervalued currency, and free trade zones for components—further reduce the incentive to seek preferential tariffs.[116] The use of preferences by China's preferential partners is very modest as well, especially in ASEAN.†

Navigating the International Trade Regime

It is difficult at first to see why China needs preferential trade to improve its balance and terms of trade. Smaller countries are susceptible to what the economist Richard Baldwin calls the "domino theory" of competitive liberalization: Country A grants preferential tariffs and ROO to country B, so country C hurries to sign an FTA with country A to avoid "trade diversion."[117] China, the world's manufacturing hub and top exporter, has less reason to fear trade diversion. WTO accession cemented its status as a global trade power, and at the same time did not deter China from adopting policies that give an unfair advantage to its exporters. In its lengthy annual report on China's WTO compliance, the Office of the U.S. Trade Representative (USTR) shows that China has failed to meet many of its commitments, particularly with respect to barriers "behind the border."[118]

What has hurt China, though, are antidumping and countervailing duty cases. China has become a top target of these trade remedies, which create uncertainty for its exporters and subject MOFCOM to litigation. Under Article 15 of China's WTO accession protocol, China agreed to be classified as a nonmarket economy for a period of up to 15 years after accession. This status has allowed WTO members to select surrogate markets for calculating the normal value of Chinese exports, which frequently results in high dumping margins on Chinese goods.‡ To eliminate this use of third-party proxy rates, China has made market recognition a prerequisite for launching FTA talks. New Zealand, eager to sign an FTA with China, became the first advanced economy to do so in 2008. By 2011, 81 countries recognized China as a market economy.[119] The efficacy of this approach is limited, since the United States and other major economies continue to use surrogate markets in their antidumping claims against China as agreed to in the accession protocol and backed up by U.S. statutory provisions. India's refusal to accord China market economy status has apparently been a major impediment to advancing bilateral FTA negotiations.[120] A more relevant question is what will happen after 2016. WTO members still have to confer market economy recognition to China on an individual basis. As such, FTAs could continue to be a useful tool for China to achieve market economy status in certain export markets.[121]

Aside from market economy recognition, preferential trade can help China's exporters in more subtle ways. China's partners are geographically dispersed and have numerous FTAs of their own. As such, they can integrate China into regional trading blocs: Switzerland and Iceland are members of the EFTA, which has an FTA with the EU; Chile is a member of Mercosur and the Andean Community; and Singapore has FTAs with most of the world's major economies. China can also use one agreement as leverage to negotiate another. The successful FTA with New Zealand, for instance, incentivized Australia to accelerate talks with China, in order to extract the same market access preferences as its neighbor. The 2010 ECFA with Taiwan appeared to revive China's teetering

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* According to the U.S. Customs and Border Protection, China is the number-one source of counterfeit goods. U.S. Customs and Border Protection, "IPR Annual Seizure Statistics," various years. *http://www.cbp.gov/trade/priority-issues/ipr/statistics*.

† A 2013 WTO study shows that only two of China's partners—Pakistan and New Zealand—have preference utilization rates of between 20 percent and 30 percent of their exports to China. China's partners under ASEAN have utilization rates of just 12 percent, while those of all other partners are below 8 percent, including Hong Kong and Macau. The only two partners that make significant use of preferences—Pakistan and New Zealand—have the least beneficial tariff arrangements with China. ASEAN and Chile, on the other hand, benefit from 92 percent and 75 percent of China's tariff being duty-free in 2011 (compared to 9 percent of the lines for most-favored-nation imports), but have very low use of preferences. Maria Donner Abreu, "Preferential Rules of Origin in Regional Trade Agreements," *World Trade Organization*, March 2013. *http://www.wto.org/english/res_e/reser_e/ersd201305_e.pdf*.

‡ For more on China's non-market economy status and its implications for penalty tariffs on China for dumping, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 108–110.

trade talks with South Korea and Japan—countries that compete with Taiwan in high-tech exports to the Chinese market.

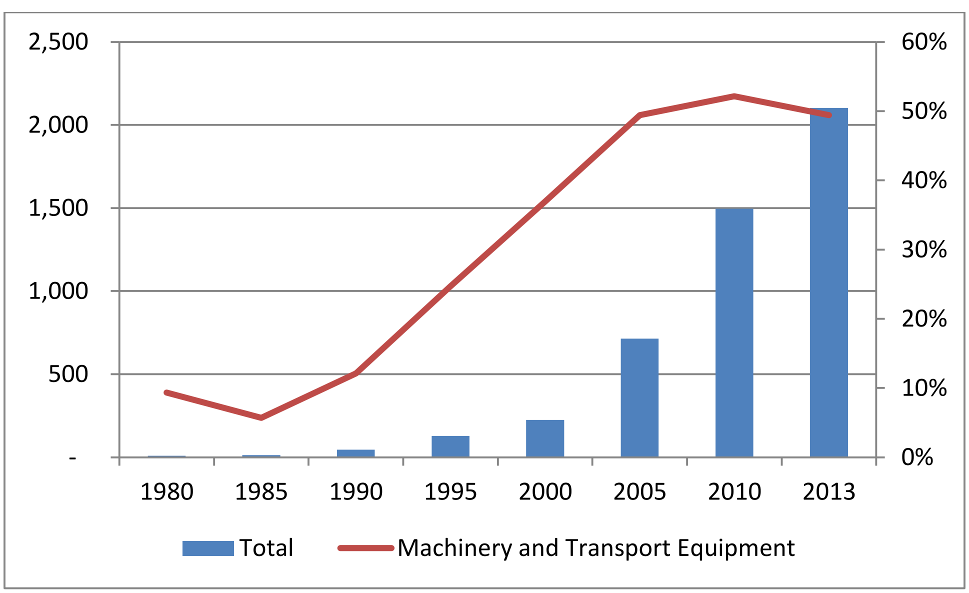
Furthermore, China can use preferential trade to forge useful alliances in the international trade regime. In the WTO, aligning with FTA partners can help China avoid trade remedies and amplify its voice in the Doha talks and in the WTO overall.[122] China's FTAs with Iceland and Switzerland in 2013 also came amid escalating trade disputes between China and the EU. Premier Li Keqiang emphasized during the Switzerland signing that the deal was sending "a strong signal against protectionism."[123]

Value Chain Dynamics

The structure of China's value chain influences the government's trade policy as well, sometimes in counterintuitive ways. On one end of the spectrum, China is a significant exporter of farm goods. Although the country lacks arable land and clean water, it is the world's largest producer of food, and its farmers depend on foreign markets to buy their horticulture and aquaculture products. Owing to the failure of the Doha Round, MFN tariffs on agriculture remain very high. China has thus sought to widen access to foreign agricultural markets in several of its preferential trade talks. These demands constituted a major source of tension in the ASEAN negotiations. The concern among Japanese and South Korean farmers about the potential influx of Chinese food imports has been a major barrier to completing those FTAs. In the China-Switzerland FTA, Bern overcame domestic opposition to place zero tariffs on more than three-quarters of China's agricultural exports to Switzerland.[124]

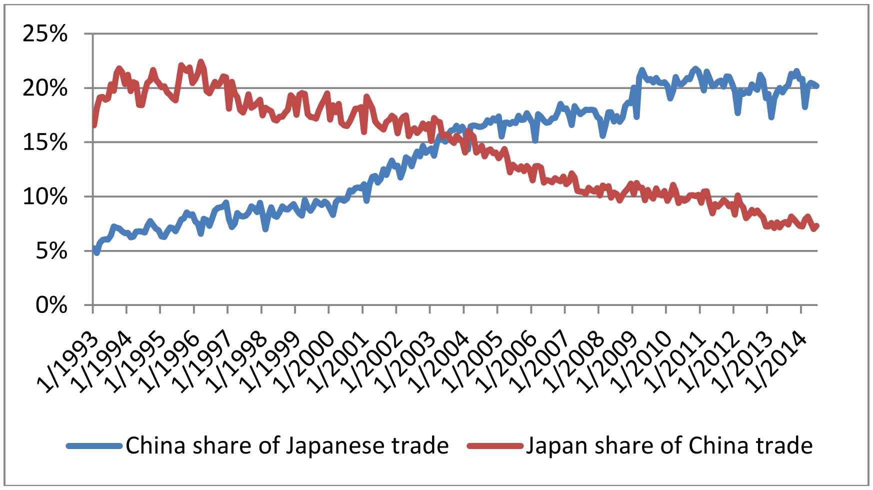
In parallel to its food exports, China wants to move up the manufacturing value chain. Indeed, machinery has been growing as a share of China's exports (see Figure 4). That helps explain why it would negotiate FTAs with Japan, South Korea, and Taiwan, countries with which it has large trade deficits. Northeast Asia supplies Chinese industry with high-technology goods, such as premium steel, machinery, and IT components, usually for assembly and re-export. The companies shipping components to China are also directly investing there. The Taiwan contract manufacturer Foxconn—which assembles products in China for Apple and other IT firms—is the largest foreign employer of Chinese workers.[125] The rising value-added of China's exports reflects its ability to appropriate and indigenously reproduce—legitimately and illegitimately—imported technologies from Northeast Asia. It bears noting that China is becoming much less dependent on Northeast Asia than the reverse (see Figure 5).

Figure 4. Machinery in China's Manufactures Exports
(US$ millions; share %)



Source: China's General Administration of Customs, via CEIC.

Figure 5. China and Japan Trade Interdependence
(monthly, share %)



Source: Japan's Ministry of Finance, via CEIC data; China General Administration of Customs, via CEIC data.

Granting Taiwan access to mainland services could reinforce cross-Strait economic linkages that spur exports and job growth in China's manufacturing centers. In this sense, the ECFA is a continuation of the CEPA, which reaffirmed Hong Kong's position as a gateway for foreign businesses to enter the mainland market, and helped integrated manufacturing operations in China's Pearl River Delta with Hong Kong consultancy, logistics and banking institutions.[126] Mainland Chinese companies indirectly benefited from Hong Kong as platform to evade the Mainland's strict capital controls, invest in real estate, and list on the Hong Kong stock exchange.

In tandem with export-oriented manufacturing, China is the world's top importer of commodities, which serve as inputs for its manufacturing, energy, and agriculture sectors. Commodity imports have come at a significant cost to China's economy. The appreciation of global commodity prices, particularly in the mid-2000s, led to a decline in China's terms of trade and increased the cost of production in downstream industries. The concentration of certain resources among few countries and producers, coupled with the fragmentation of Chinese industries, also placed China at a disadvantage in setting prices.

China has attempted to use FTAs to mitigate these trends. Its current and prospective partners are key commodity suppliers: Australia and New Zealand produce mineral and farm goods; Chile and Peru supply iron ore and copper; Iceland and Norway host valuable oil and gas assets, as do Indonesia (part of ASEAN), Australia, and the Arab states of the Persian Gulf (see Table 7).

Table 7. China's Imports from Select Trade Partners and the Share of Resources

		2003	2008	2013
Indonesia	Total imports (US$ m)	5,754	14,387	31,479
	Mineral products share (%)	22%	37%	59%
Chile	Total imports (US$ m)	2,245	11,362	20,800
	Mineral products share (%)	na	35%	36%
Australia	Total imports (US$ m)	7,303	36,284	98,468
	Mineral products share (%)	39%	75%	75%
New Zealand	Total imports (US$ m)	1,023	1,891	8,252
	Animal products share (%)	27%	26%	54%

Source: China's General Administration of Customs, via CEIC.

China has attempted to use preferential trade to improve its commodity supplier relationships in numerous ways:

- *Prohibiting export restrictions.* WTO rules on export restrictions are comparatively weak in resource sectors. The goal is therefore to include preferential clauses that commit the supplier not to apply resource export restrictions, or at a minimum limit the circumstances under which they can be used. This policy has been difficult to implement—unlike the exchange of tariff offers typical for manufactured goods, resource trade commitments are an asymmetric concession made by the resource exporter.[127]

- *Securing lower and more stable prices.* China prefers long-term agreements under which the resource supplier agrees to sell at a pre-negotiated price that insulates China from market uncertainty. The logic is that a government in FTA partner countries may be more inclined to weigh in on domestic resource producers who want to raise the price of commodities shipped to China. China has apparently insisted on a related clause in its FTA with Australia, though experts speculate that Australia has refused to include it.[128]

- *Ending any discrimination against Chinese investments in mines, oil and gas fields, and farmland.* FTAs could include provisions to establish intergovernmental programs to promote bilateral resource investment, or more tangibly, reform FDI regimes through supplier commitments to extend legal protections to the foreign investor. In Australia, China has insisted specifically that the FIRB revise its statutes on the treatment of Chinese investors, though provisions for mandatory screening of SOEs remained in force after the conclusion of the FTA.

- *Increasing China's competitiveness in resource bidding.* Although not explicitly spelled out in FTAs, the diplomatic goodwill engendered by bilateral accords can ease access for China to exploration sites that are subject to bidding procedures. In this respect, China has had some success. In November 2013, for example, just months after the bilateral FTA between China and Iceland was signed, the National Energy Authority of Iceland (Orkustofnun) approved the Chinese state oil company CNOOC International Ltd. as a partner and co-applicant with Eykon Energy for exploration and production of a hydrocarbons license—the third to be issued—in waters off northeast Iceland. Norway is authorized to seek licenses awarded by the Icelandic government as part of a 1981 treaty between the two, and seek outside partners. China is also negotiating an FTA with Norway.[129]

- *Seeking membership in regional bodies that impact resource shipping.* China joined the Arctic Council in May 2013, roughly coinciding with its FTA with Iceland. China has a keen interest in shipping goods through the Arctic, being among the first countries to send a large cargo ship through the Arctic in the summer months. This route would drastically cut transport time and cost for both exports and imports.[130]

- *Political signaling.* FTAs can help build trust between the parties and lessen the prospects of a supplier engaging in adverse policy decisions. A variety of devices to achieve these goals could be included, such as institutionalized policy dialogues, joint investment promotion efforts and diplomatic commitments for parties to work together to achieve common resource policy goals. Although strictly noneconomic, suppliers can indicate their intention to be reliable partners.[131]

According to the political scientist Jeffrey Wilson, China took a page from South Korea and Japan, who incorporated resource security into their FTA objectives in the early 2000s.[*] Indeed, China may be competing with these countries to get equal preferences from the Australian government. Citing interviews with Japanese

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[*] According to Jeffrey Wilson, Japan was the first country to make resource security a priority objective in its FTAs. Japan published a new FTA strategy in 2004 that included in its partner selection criteria whether an FTA could "contribute to stable imports of resources." This was subsequently reinforced in its 2006 "Global Economic Strategy." This strategy was put into practice in FTA initiatives with Indonesia, Chile, Brunei, India, Peru, the Gulf Cooperation Council (GCC), Australia, and Canada. Natural resources were prioritized in all of the negotiations, with the stated aim of securing investment clauses to protect Japanese investors. By the end of the decade FTAs had been completed with six resource suppliers. South Korea's case was almost identical. Using FTAs for resource security purposes was first suggested in 2006, when Seoul included resource security as a rationale for an FTA proposal to Mercosur. By late 2010, initiatives with nine resource suppliers had been launched, all of which prioritized investment protections and resource cooperation clauses. South Korea's Ministry of Foreign Affairs and Trade indicated that its 2011 goals were to conclude negotiations with Australia and open new talks with "resource-rich countries in Africa, the Middle East and other regions." Jeffrey D. Wilson, "Resource Security: A New Motivation for Free Trade Agreements in the Asia-Pacific Region," *The Pacific Review* 25:4 (2012): 438–439.

officials, Wilson claims that Japan's decision to open FTA negotiations with Australia in 2005 was in reaction to the increase in Chinese investment in the Australian mining industry. Japanese firms worried that they might be locked out of a critical market. An FTA with resource and investment commitments could help neutralize this disadvantage. After Australia gave Japan an in-principle agreement to include a resource clause in August 2007, China responded by requesting resource investment commitments in the next round of negotiations in June 2008. South Korea commenced FTA negotiations with Australia in early 2009 and also requested a resource clause.[132]

Interest Groups in an Authoritarian State

China's authoritarian regime and state-dominated economy often conflict with the advanced provisions in trade agreements. While China has revised its labor law several times, it still restricts freedom of association and collective bargaining. That effectively preempts implementation of several ILO standards captured in the U.S. FTAs. China's broad definition of national security interests also impedes liberalization in strategic industries. Allowing in more foreign banks or loosening up capital transfer restrictions impinges on China's monetary policy, which is premised on capital and currency controls and direct influence over credit growth. China's politically motivated censorship of the Internet, as well as state-directed commercial cyber theft of critical technologies, make it difficult for China to commit to U.S.-model rules on digital trade and data transfers.

Over 40 percent of China's corporate assets remain in state hands today.[133] The commanding heights of China's economy—sectors like telecommunications, banking, and energy—are controlled by SOE oligopolies. The status of the largest SOEs is equivalent to a government ministry, and there is a revolving door between SOE executives and positions in the Party apparatus. SOEs also persist in less concentrated industries, from services like mining, transport, and hospitality to heavy industries such as steel making and machinery.[134] China would have to make substantial changes to comply with U.S. standards on competition policy (e.g., creating a level playing field, limiting SOEs to public services, transparent ownership). Non-discrimination in government procurement is also a tall order, since China's procurement policy favors SOE goods and services.

Nonetheless, interest groups in China can shape trade policy, sometimes with less predictable outcomes. Agriculture is a good example. In the WTO accession protocol, MOFCOM agreed to trenchant cuts in China's agriculture tariffs. In the ensuing years, China's Ministry of Agriculture (MOA) complained that a post-WTO surge in imports hurt the country's farmers.[135] Like China's industrial workers, Chinese farmers have no institutional mechanism to organize collectively. But the MOA is concerned that rural instability can threaten the Communist regime and its efforts to manage the country's "floating population" of rural-urban migrants.

If the MOA has a protectionist outlook, why has China signed FTAs with agricultural exporters and cut tariffs on agricultural goods? Part of the answer is that preferential trade can promote China's agricultural exports, giving the MOA an incentive to accept tradeoffs on the import side. More importantly, the Party leadership has trumped MOA interests in select cases. China's decision to lower tariffs on dairy imports from New Zealand, for instance, was politically opportune. Around the time that Beijing and Auckland concluded their FTA in 2008, a litany of food and drug safety scandals damaged consumer confidence. One of these concerned melamine-tainted milk that caused the poisoning of thousands of infants. Under those circumstances, lowering tariffs on premium dairy imports was an expedient means to defuse public anger. Since the tariffs were lowered on a preferential basis only, the damage to domestic producers could also be contained. A similar logic applies to China's imports of premium beef: China has responded to domestic demand by permitting beef shipments from New Zealand and the then prospective FTA partner Australia, but not from the United States, even though U.S. products are of the same quality.[136]

Produce imports from ASEAN are another example. China opened its market to tropical fruit imports from ASEAN members, knowing that this would harm farmers in Guangxi and Yunnan provinces in the southwest. To offset this, the central government offered de facto "trade adjustment assistance" by designating Guangxi as the host of the annual China-ASEAN expo and by providing Yunnan with additional funding for infrastructure development.[137]

In the ECFA early harvest agreement, China opened its market to farm imports from Taiwan. As with ASEAN, support likely came from political higher-ups—in this case, the Party Central Committee Leading Small Group on Taiwan Work and the Chinese People's Political Consultative Conference. Unlike in the ASEAN case, though, Taiwan's farmers are not very price-competitive in the Chinese market. Rather, Beijing subsidizes wholesale buyers to procure the expensive food items from Taiwan as a token of goodwill. Wholesalers frequently pocket the subsidies and then cast the Taiwan-grown fruits into the sea.[138]

Whether in agriculture or other industries, the preferences of China's leadership can determine the balance of power among government agencies. In the 1990s, the administration of President Jiang Zemin and Premier Zhu Rongji (1993–2002) established a special leading group to coordinate China's WTO accession. The leadership strongly supported MOFCOM in the WTO negotiations and was willing to institute market reform and industry restructuring to satisfy WTO demands. The succeeding administration of President Hu Jintao and Premier Wen Jiabao (2003–2012), however, sought primarily to protect domestic industries from the consequences of WTO-induced liberalization. Declining support from the leadership weakened MOFCOM's ability to push through a reform agenda.

As a result, other government agencies have gained in influence—not only the MOA, but also the National Development and Reform Commission (NDRC), a "super-ministry" in charge of economic planning, price setting, and administrative approvals. The NDRC does not participate in trade negotiations but can be decisive in blocking market opening.[139] Given that the ascent of the NDRC is fairly recent, though, future leaders could decide to reverse the trend and endow MOFCOM with the type of power it enjoyed in the 1990s.

The Strategic Dimension

Regional Security

It is not uncommon for countries to pursue preferential trade for noneconomic reasons. A trade surplus contributes to the economic prosperity that underpins a strong military. Increasing economic interdependence can disincentivize conflict and strengthen a country's diplomatic leverage. The United States certainly pursues preferential trade for strategic reasons: Washington has signed FTAs with less significant economies in strategically vital regions (e.g., the Middle East) and in its immediate periphery (e.g., NAFTA and CAFTA), while TPP is part of a "rebalance" to Asia that also includes a military component.

In China's case, however, noneconomic motives occupy an outsized and distinctive place in trade policy. At the top of Beijing's list is the imperative to protect China's territorial integrity. The CEPA agreements were signed soon after the semiautonomous jurisdictions Hong Kong and Macau were handed over by the United Kingdom and Portugal in 1997 and 1999, respectively. China maintains a "One Country, Two Systems" policy in these territories. Moreover, the ECFA with Taiwan is designed to reinforce the non-sovereign status of the Republic of China on Taiwan. China classifies CEPA and ECFA as "arrangements" instead of FTAs between sovereign governments—making use of a loophole in the WTO system that allows for trade agreements with "customs territories." Taipei in fact objected to the term CEPA, which would have placed its sovereignty status on par with Hong Kong and Macau, but consented to the term "economic cooperation framework agreement." Moreover, the China-Taiwan ECFA was signed not by national governments but by semi-official organizations: China's Association for Relations across the Taiwan Straits and Taiwan's Straits Exchange Foundation.

China's One Country policy has taken on global dimensions. Among the countries that give diplomatic recognition to the People's Republic of China, Beijing has sought to ensure that Taiwan signs only a minimal number of trade agreements, and not do so as a sovereign state. Under WTO rules, Taiwan is legally permitted to sign FTAs, but prospective partners have refrained from engaging with Taipei for fear of upsetting Beijing. This chilling effect has thawed since the ECFA, as evidenced by Taiwan's commercial agreements with Singapore and New Zealand. Still, these agreements are not called "free trade agreements" and recognize Taiwan only as a customs territory, thereby diminishing Taiwan's sovereignty claims in the international community. Although the Kuomintang, the current party in power in Taiwan, is optimistic that more agreements are possible, opponents argue that Beijing would not allow Taipei to sign agreements with trade partners with whom China does not already have agreements—such as Japan, the United States, and the EU.[140]

China has also signed other FTAs on the basis of its Taiwan policy. Chile was the first South American country to establish a diplomatic relationship with China (December 1970), and incidentally became China's first FTA partner in that region. India, Pakistan, Norway, and Switzerland already recognized China in the 1950s, decades before China had a seat at the United Nations. China has held FTA negotiations with all four. Singapore took until 1990 to switch diplomatic recognition from Taiwan to China, but did so at a crucial moment when China faced diplomatic isolation over the 1989 Tiananmen Square Massacre. The most obvious case of Taiwan containment is China's FTA with Costa Rica. Bilateral FTA talks began just one year after San Jose switched diplomatic recognition from Taipei to Beijing. Switching recognition was a difficult decision for Costa Rica, since Taiwan had provided generous aid support for decades, and neighboring countries in Central America still recognized the Republic of China on Taiwan.[141] In the four years before Costa Rica's switch, Taiwan signed a flurry of FTAs, all with Central American countries: Panama (August 2003), Guatemala (September 2005), Nicaragua (June 2006), and El Salvador and Honduras (November 2006).

Besides territorial integrity, China has tried to reassure its neighbors that it will not threaten economic or geopolitical stability. The FTA with ASEAN is a centerpiece of this diplomatic effort. China began ACFTA negotiations at a time when its trade negotiators had signed no other FTA and were in the midst of WTO accession talks. The timing was not coincidental: The ACFTA proposal was originally mooted at the first ASEAN-China Summit in 1997, at a time when ASEAN members were struggling to cope with the effects of the 1997–1998 Asian Financial Crisis. ASEAN's founding members opposed Communist China during the Cold War; by the 1990s, their "China threat" perception turned from national security to trade, as the bloc's members worried that China would out-compete local manufacturers in home and third markets once it joined the WTO.

At the time the ACFTA talks were launched, Japan was the world's second-largest economy and the primary external actor in Southeast Asia. Today, Japan's influence has eroded, but Tokyo still competes with Beijing as a prolific signatory of trade agreements, a competitor for resource imports, and an important provider of capital and technology to countries throughout the region. Compounding the Sino-Japanese economic rivalry are strategic tensions that date back to the late 19th century.[*]

Promoting Alternative Norms

Although poorly defined, there is also a normative dimension to China's trade policy. For one, China officially claims it prioritizes mutual benefit and flexibility over self-interest and absolute norms. Chinese officials and scholars refer frequently to the official mantra of "do good to our neighbors, treat our neighbors as partners" and "maintain friendly relations with our neighbors, make them feel secure, and help to make them rich."[142] To build its relationship with ASEAN, for example, China agreed to confidence-building measures that supplemented the ACFTA, notably the Chiang Mai Initiative launched in 2000 to pool reserve currencies as a buffer against capital outflows. China also prides itself on making agreements accessible to developing countries. In this respect, the shortage of legalistic language, limited opening of sensitive industries, and slow tariff phase-outs (especially for the low-income countries in ASEAN) are viewed by Beijing as a sign of strength rather than weakness.[143]

Some Chinese scholars also claim that China's willingness to grant asymmetric concessions is a sign of benevolent hegemony—or "big country generosity"—that has historical roots in China's tributary system. At the same time, China's occupies a very different role in Asian regional integration than the United States does in the Americas. NAFTA and CAFTA signatories had few prior FTA groupings, so the United States served as the glue binding others together. ACFTA, on the other hand, is a "one-to-many" or "hybrid bilateral" arrangement, since the ASEAN members have a preexisting FTA amongst themselves.[144] China has not objected to ASEAN's FTAs with other Asian economies, since its official policy is to defer to ASEAN as the leader in regional integration.[145]

The wording in U.S. and Chinese FTAs suggests that China is pursuing a distinctive paradigm for its trade deals, even if the details are poorly defined. Since China and the United States signed respective FTAs with Chile and Peru in the 2000s, these documents are a good point of reference. In the Cooperation Framework section of China's FTA with Chile, the two sides agree to pursue "cooperation" across many fields, ranging from the economy to scientific research and even culture. It places a unique emphasis on small businesses, which are to be promoted in both countries. While it does contain sections on labor, social security, and environmental

[*] Japan played an important role as an investor in China during the 1980s. But that did not alleviate the strategic rivalry between the two countries. The adversarial relationship has its roots in the Sino-Japanese War of 1895, Japan's colonization of Manchuria in the interwar period, wartime atrocities, and Cold War divisions. Rivalry aside, China sought to translate its economic rise into diplomatic influence.

cooperation, the legal clauses behind them are not spelled out in the FTA; rather, reference is made to a Memorandum of Understanding for Labor and Social Security Cooperation, and an Environmental Cooperation Agreement. Needless to say, those agreements are not legally binding. The China-Peru agreement is even less forthcoming, where the Cooperation Framework makes no mention at all of labor or environmental standards.[146]

In the U.S. FTAs with Chile and Peru, little ink is spilled on how the two countries can strengthen "cooperation" of any sort. Rather, the Cooperation Framework is divided into three parts, each of which tackles head-on the issues not dealt with in the Chinese FTAs. The first refers to labor issues: the United States and its counterparty agree to enforce labor laws set forth in the ILO Declaration on Fundamental Principles and Rights at Work; to raise public awareness about labor rights; and to jointly set up a labor affairs council that can adjudicate any labor disputes that may arise, along with a labor roster that lists experts who could be summoned to participate in the council. The second part of the Framework, which deals with the environment, is quite similar: the two sides agree to enforce environmental laws with reference to WTO agreements; to encourage participation by and consultation with the public; and to set up an environmental affairs council and accompanying roster. More impressively, the environment section also comprises a painstaking list of definitions for specific types of environmental issues, and an annex on environmental cooperation that addresses specific areas of cooperation, such as projects to reduce carbon emissions and pioneer cleaner fuels. Finally, the U.S.-style Cooperation Framework contains a whole section on "transparency," setting out rules for publication, provision of information, and administrative proceedings.[147]

Similar differences emerge in the preamble of the agreements. The U.S. version is notable for the many lofty goals it aims to achieve. On the business side, the two parties aim to "enhance the competitiveness of […] firms in global markets" and "foster creativity and innovation, and promote trade in goods and services that are the subject of intellectual property rights." Beyond business, the U.S.-Chile FTA again places a heavy emphasis on labor rights: the two countries are to help generate employment, strengthen cooperation on labor matters, and "protect, enhance, and enforce basic workers' rights." On the environment, the two sides agree to implement the FTA "in a manner consistent with environmental protection and conservation"; to "promote sustainable development"; and to "conserve, protect, and improve the environment, including through managing natural resources in their respective territories and through multilateral environmental agreements to which they are both parties." There is also a line highlighting the need to "safeguard the public welfare."[148] The preamble to the U.S. FTA with Peru includes not only these items, but also refers to combating corruption and "generating opportunities for sustainable economic alternatives to drug-crop production."[149]

The preambles of China's agreements with Chile and Peru are terser. In line with the "win-win" and "South-South" cooperation rhetoric that China often uses when engaging with developing countries, the parties agree to "promote reciprocal trade through the establishment of clear and mutually advantageous trade rules." No mention is made of helping private firms or protecting intellectual property rights. The broad issues of labor, sustainability, and the environment are covered in one brief statement:

> *RECOGNIZING that this Agreement should be implemented with a view toward raising the standard of living, creating new job opportunities, and promoting sustainable development in a manner consistent with environmental protection and conservation; and*
> *COMMITTED to promoting the public welfare within each of their countries.*[150]

China's lack of attention to labor and environmental issues in its FTAs reflects the broader preferences of its authoritarian system of government. In the case of Norway, which like Iceland and Switzerland is a member of the EFTA, China went so far as to suspend FTA negotiations in response to criticism of its human rights record. China and Norway launched a joint feasibility study for an FTA in 2007, and negotiations officially began in September 2008.[151] However, Beijing suddenly cancelled trade talks after the eighth round in September 2010 in protest of Chinese dissident Liu Xiaobo's impending receipt of the Nobel Peace Prize in October of that year.[152] The Norwegian government explained the Nobel decision was not under its control, since the Nobel Committee is independent of the government. China nonetheless took measures to express its dissatisfaction. In addition to suspending FTA talks, China also denied entry of Norwegian salmon shipments into China and excluded Norway from its visa reform, which allows foreigners to enter China for 72 hours without a visa.[153] Trade talks have yet to resume, though China still lists the China-Norway FTA as "under negotiation" on its website.

Conclusion: The Way Forward for Washington

On issues of economics and trade, the United States interacts with China in two ways. One is through its direct negotiations with Beijing, including at the WTO and at the annual U.S.-China Strategic and Economic Dialogue (S&ED). For example, at the July 2013 S&ED, the two countries committed to continuing negotiation toward a BIT.[154] The United States must also determine whether to include China in WTO plurilateral agreements, and how to more effectively address China's non-compliance with WTO rules.

Aside from direct engagement with China, the U.S. government interacts with China indirectly through U.S. trade policy. The United States is dealing with countries in the TPP negotiations that could serve as a litmus test for future negotiations with China. For example, Vietnam, like China, is an authoritarian state with weak labor rights. Vietnam, Malaysia, and Singapore are also good gauges for how U.S. trade rules will address prospective challenges posed by SOEs. Japan, in turn, is a test case for how the United States can promote widening of access to agriculture, investment, and services—all sectors where China resists market opening as well.

At the same time, as Chinese trade initiatives proliferate, China's current and prospective preferential trade partners are beginning to overlap with the United States, which has important implications for standard setting in the international economic arena. In regions outside Asia, the following patterns are apparent:

- *Americas*. China has signed FTAs with three U.S. FTA partners in this region: Chile, Costa Rica, and Peru. Costa Rica is noteworthy not only because the United States has many FTA partners in Central America, but also because several countries in that sub-region still maintain diplomatic relations with Taiwan (and are Taiwan's only sovereign trade agreement partners). Further, China has signed fairly advanced BITs with NAFTA members Canada (2012) and Mexico (2008), which can provide the basis for negotiating investment chapters in FTAs. Given that Canada and Mexico joined the TPP talks in 2012, these countries may serve as an important link between China and the evolving TPP chapter on investment.[155]

- *Europe*. China is engaging with Switzerland and Iceland, small countries that constitute half of EFTA members, whereas the United States is now negotiating the TTIP mega-regional with the EU. A top EU trade official stated in September 2012 that "we don't think the time is right for an EU-China FTA, but we think we can move ahead in areas like an investment agreement. The problem is that China's interests are too narrow. China isn't interested in market access."[156] In the meantime, the EFTA's trade partnership with the EU (both are part of the PanEuroMed system[*]) means that China has taken the first step toward integrating preferential trade with the EU. China wanted to sign an agreement with Norway until the awarding of the Nobel Peace Prize to Chinese dissident Liu Xiaobo in 2010 derailed the talks.

- *Middle East and Africa.* In the summer of 2004, China launched negotiations with both the South African Customs Union (SACU)—a union that comprises South Africa, Botswana, Namibia, Lesotho, and Swaziland—and the Gulf Cooperation Council in the Middle East.[157] This coincided with a more active engagement in the region by the United States, which began negotiations with SACU in 2003, and signed an FTA with Bahrain in September 2004 that set the stage for its Greater Middle East Initiative.[158] In Sub-Saharan Africa, however, both China and the United States have suspended their talks with SACU. Yet China's current talks with the GCC create potential for some overlap—the United Arab Emirates ambassador to China stated in April 2013 that the China-GCC agreement is close to being finalized.[159]

[*] In the context of the PanEuroMed system, products which have obtained originating status in one of the 42 countries may be added to products originating in any other one of the 42 without losing their originating status within the PanEuroMed zone. That makes it easier for producers in these countries to qualify for preferential tariffs. The system operates between the 28 member states of the EU, the EFTA states (Iceland, Liechtenstein, Norway, and Switzerland), the countries that signed the Barcelona Declaration (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, and the Palestinian Authority of the West Bank and Gaza Strip), and Turkey and the Faroe Islands.

The United States signed a Framework Agreement for Trade, Economic, Investment and Technical Cooperation with the GCC in May 2012, which sets general terms for a future FTA.[*]

In Asia, U.S. and Chinese agreements have less overlap. Singapore is the only country that has an FTA with both Beijing and Washington. Chinese negotiations with South Korea and Japan are still in early stages. Other FTAs present interesting case studies:

- *Australia and New Zealand*. Australia constitutes an important bridge between U.S. and Chinese trade interests. Australia is a principal U.S. ally in the Asia Pacific. At the same time, China is now Australia's number one trade partner. Australia is part of both the RCEP and TPP negotiations, and at the bilateral level, has an FTA with the United States and has just concluded a deal with China. For China, New Zealand is also key, having been the first country to grant China accession to the WTO and the first advanced economy to sign an FTA with China.

- *Emerging economies in Asia.* Thanks to the ACFTA, which came into full force in 2010, China has an FTA in place with nine developing economies in the East Asia region. Of these, only Malaysia and Vietnam are participating in the TPP negotiations. In South Asia, Beijing has an FTA in place with its long-time ally Pakistan, which has a complex diplomatic relationship with Washington. As for India, Beijing and New Delhi completed a joint feasibility study for an FTA back in 2008, but bilateral FTA talks have made little progress. India would, however, be part of an RCEP arrangement.[†]

- *Taiwan*. Beijing views its bilateral FTA with Taiwan, the ECFA, as an agreement between two customs territories within one sovereign state. Taiwan has been precluded by China from signing FTAs with other countries as a sovereign state. The United States and Taiwan share a special security relationship dating back to the 1979 Taiwan Relations Act.[‡] Although the United States and Taiwan have explored the potential of a bilateral FTA for over a decade, bilateral trade negotiations have not materialized. Taiwan is, however, keen to join the TPP talks. As of August 2014, it was engaged in an "administration-wide effort to ready itself for eventual accession" to the TPP, including the creation of a patent linkage system for marketing approval of pharmaceuticals.[160]

Going forward, different stakeholders in the United States will need to work out how the TPP can best serve the national interest. In theory, the TPP can serve several purposes. The agreement is expected to expand market access for U.S. goods and services outside the WTO, particularly by removing non-tariff barriers. The TPP could also refresh and build on the 1994 NAFTA and the bilateral FTAs that the United States has with certain TPP members. Some economists argue that, as opposed to fiscal and monetary policy, free trade is a "cost-free" form of economic stimulus. At the same time, the TPP can consolidate the U.S. "Asia pivot" by strengthening relationships with U.S. allies in the Asia Pacific.[161] Mega-regionals could help preserve U.S. influence in the 21st century trade regime by promoting a "premium" standard that the WTO is unable to deliver and many FTA signatories are unwilling to enforce.

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[*] This U.S.-GCC Agreement will establish a Joint Committee to discuss areas where both the GCC and the United States share mutual interests, including considering opportunities for enhancing economic, commercial, investment and technical cooperation, fostering their economic relations and increasing the volume of trade and investment between them. Office of the U.S. Trade Representative, *Ron Kirk Announces Agreement with Gulf Cooperation Council to Strengthen Economic Ties, Expand Trade and Investment Relationship*, September 2012. *http://www.ustr.gov/about-us/press-office/press-releases/2012/september/ustr-kirk-announces-agreement-gcc*.

[†] According to China's Ministry of Commerce, the latest status of the China-India FTA is as follows: "In 2003, China and India established a Joint Study Group to examine the potential for economic engagement between the two countries. In October 2007, the Joint Task Force finalized its report on the feasibility of a China-India Regional Trading Arrangement (RTA). According to the feasibility report, a China-India RTA will be mutually advantageous. Both sides welcomed the conclusion of the feasibility study on the RTA between the two countries, and agreed to explore the possibility of commencing discussions on a RTA that meets the common aspirations of both countries and will also benefit the region." China Ministry of Commerce. *http://fta.mofcom.gov.cn/topic/enindia.shtml*.

[‡] The Taiwan Relations Act is an act of the U.S. Congress that, since the recognition of the People's Republic of China, has defined the non-diplomatic relations between the United States and the Republic of China on Taiwan.

Critics point out that after the United States formed NAFTA, granted permanent normal trade relations to China, and signed a bilateral FTA with South Korea, its trade deficits with these economies widened. Moreover, given that the United States is already a very open economy, the sectors that its TPP partners now want to open—such as dairy farming, automotive, and textiles—would impact sensitive sectors of the U.S. economy. To protect vulnerable economic groups, the United States can negotiate special provisions—such as carve-outs, phase-ins, safeguards, and strict ROO—but this might taint the integrity of the U.S. commitment to free trade. Still others contend that TPP talks are diverting the USTR's scarce resources away from the WTO Doha Round.

In the meantime, China is attempting to define the trade agenda in Asia and become the focal point for regional economic integration. In addition to the ongoing RCEP negotiations, China has pushed for a revival of the Free Trade Area of the Asia Pacific (FTAAP). If completed, FTAAP would be the first agreement in the Asia Pacific incorporating both the United States and China. FTAAP would include many of the same members and issue items as the TPP so there is potential for harmonization. However, FTAAP negotiations could also divert attention from the TPP and, by extension, U.S. emphasis on high-standard trade rules in Asia.[162]

Even if Washington integrates China into higher-standard initiatives on some fronts, China will retain the ability to align with those who oppose aspects of the U.S. agenda, and find ways to undermine the spread of U.S. norms. China has approached trade agreements in a more opportunistic and less consistent manner than the United States, and that is unlikely to change under President Xi. Since the 2013 leadership transition, Beijing is reverting to a policy China used in the late 1990s, when the prospect of joining the WTO served as a conduit for domestic reform. But while the WTO exacted rigorous demands, preferential trade allows China to make concessions incrementally and selectively. This hedging strategy defuses pressure and buys time for China's new leaders to increase their leverage.

Acronyms

ACFTA	ASEAN-China Free Trade Area
AJCEP	ASEAN-Japan Comprehensive Economic Partnership
APEC	Asia Pacific Economic Cooperation
APTA	Asia Pacific Trade Agreement
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment treaty
CAFTA	Central American Free Trade Agreement
CEPA	Comprehensive Economic Partnership Agreement
CRTA	Committee on Regional Trade Agreements
CSSTA	Cross-Strait Service Trade Agreement
ECFA	Economic Cooperation Framework Agreement
EFTA	European Free Trade Association
EU	European Union
FDI	foreign direct investment
FIRB	Australia's Foreign Investment Review Board
FTA	free trade agreement
FTAAP	Free Trade Area of the Asia Pacific
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GPA	Agreement on Government Procurement
ILO	International Labor Organization
IP	intellectual property
ITA	Information Technology Agreement
MFN	most favored nation
MOA	China's Ministry of Agriculture
MOFCOM	China's Ministry of Commerce
NAFTA	North American Free Trade Agreement
NDRC	China's National Development and Reform Commissions
RCEP	Regional Comprehensive Partnership
ROO	rules of origin
S&ED	U.S.-China Strategic and Economic Dialogue
SACU	South African Customs Union
SAR	special administrative region

SOE	state-owned enterprise
SPS	sanitary and phytosanitary
TISA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
USTR	Office of the U.S. Trade Representative
WTO	World Trade Organization

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