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From a Follower to a Rule-Shaper: Augmenting China's FTA Policy

Justyna Szczudlik-Tatar

In Xi Jinping's term, China has pursued active economic diplomacy. One of its manifestations has been free trade agreements. Apart from economic rationales—trade and investment creation effects—political considerations have played a role as well. FTAs build China's leadership and establish its status as a rule-maker. Beijing's concerns about two key trade agreements, TPP and TTIP, which will introduce new norms to the global economy, might be incentives for China to step up with ambitious agreements to avoid being bypassed. As China–EU FTA talks are not on the table, the Union should concentrate on an investment treaty with Beijing and engage China in multilateral WTO negotiations to address the EU's demands.

A strategy of establishing free trade agreements (FTAs) is becoming the handmaiden of China's attempt to transform itself from a world's rule-follower to an agenda-setter and to make the country's voice heard globally. In a December 2014, Xi Jinping called for the acceleration of China's FTA strategy to further economic openness and shape global rules. Earlier, in mid-2014, China's first FTAs with European countries—Iceland and Switzerland—came into force, while at the end of year Beijing finalised FTA negotiations with South Korea and Australia. Also, at the APEC summit in Beijing, Xi proposed talks on a Free Trade Area for the Asia-Pacific (FTAAP). All of these are signals of Beijing's upcoming worldwide economic offensive.

Evolution of China's FTA Approach. China is a latecomer to the use of FTAs. Before 2001, Beijing was focused on finalising its WTO membership. What is more, at that time China had a rather small export volume and huge export partners (EU, U.S.), thus it was premature to seek new markets or negotiate such agreements. But a stalemate in the WTO trade talks, economic integration trends (NAFTA, Mercosur, EU, ASEAN), the rising number of bilateral and multilateral FTAs in the world, and China's increasing exports prompted Beijing to modify its FTA stance. In 2000, China offered ASEAN the first chance at FTA talks. This was a signal that China did not want to remain behind the world's trends and was hedging the risks stemming from global economic integration and the new FTAs signed by major exporters and importers.

Since then, FTAs have played a more important role in China's reform agenda. So far, China has 12 FTAs in force: with ASEAN, Hong Kong, Macau, Chile, Pakistan, New Zealand, Singapore, Peru, Costa Rica, Taiwan, Iceland and Switzerland. Pacts with South Korea (ROK) and Australia will be officially signed this year. China is negotiating a Regional Comprehensive Economic Partnership (RCEP) and is in talks with Norway, Sri Lanka, and the Gulf Cooperation Council, Japan and Korea (trilateral agreement). It is considering negotiations with India and Columbia.

China's FTA strategy is evolving from "ordinary" pacts that focus on trade in goods, mainly through tariff reductions (ASEAN), to those that involve trade in services and investment (NZ, Singapore), trade facilitation, rules-of-origin, competition policy, intellectual property rights, environmental issues, dispute settlements (RCEP, Iceland, Switzerland, South Korea) and others. The prime focus was on agreements with neighbouring small, developing countries and regions first (ASEAN, Hong Kong, Macau, Chile, Peru), small but more developed Asia-Pacific states (Singapore, NZ, South Korea, Australia), and now on small, distant and developed economies (Iceland, Switzerland). Recently, China has been keen on initiating regional projects in which it wants to play a leading role. The FTAAP—an initiative to

establish a free trade area with all of the Asia-Pacific states—is an element of this approach to re-affirm China's position in the region and balance the U.S.-led TPP.

Economic Rationales. China's decision to negotiate FTAs is mainly economic. For an export-oriented and FDI-heavy economy, trade and investment creation is a focal point. The main goal is market access and increased export competitiveness. These targets are visible in China's FTA network. Beijing prefers agreements with exporters of raw materials and agricultural products, and with importers of textiles and electronic devices. In addition, China's desire to increase its status in the international production chain, to internationalise its currency, and further integrate with the world's economy has led it to foster economic ties with such FTA centres as Singapore, Chile (Mercosur), Switzerland and Iceland (members of the European Free Trade Association) as a way to explore new markets and gain access to trading hubs.

Now, in the context of the stalemate in the WTO trade talks, surge in FTAs and trend of negotiating new standard agreements (TPP, TTIP, EU-led concords). Beijing is signalling its readiness to negotiate accords with developed, larger economies, despite there are issues that may be difficult to change for the export-oriented and state-ruled economy (e.g., labour standards state-owned enterprises, non-trade issues, etc.). But, Beijing does not want to be marginalised. Without a network of ambitious FTAs, China believes its economic interests could be compromised. The country is now mainly concerned by TPP and TTIP (called a "new WTO" or an "economic NATO"). If successfully concluded, these pacts might pose a severe impact on exports to China's biggest export markets: the U.S. and EU. Beijing is afraid of a trade diversion effect, which means it may lose its advantage to cheaper exporters, such as Southeast Asian states. This is especially concerning because the EU has concluded or is negotiating agreements with Korea (in force since mid-2011), Singapore (negotiations finalized in late 2014), Japan, Vietnam, Thailand and Malaysia. These pacts, if signed, would establish new norms for future FTAs, and China, despite its rising economic and political clout, might continue to be a rules-follower, rather than the agenda-shaper it aims to be. Initiating new FTAs (with European and developed Asian economies), pressure on countries and regions to launch FTA talks (e.g., the EU) and strengthening its overall FTA strategy are ways China is trying to catch up with the global economy and implementing Xi's dream for China to become a superpower.

Foreign Policy Tool. The FTAs may not have only economic considerations. The agreements are used as foreign policy tools to show favour for other countries, build China's leadership, and reward friendly policies, such as formal recognition of China as a market economy (Pakistan, NZ, Iceland, Switzerland), or the termination of diplomatic ties with Taiwan (Costa Rica). The FTAs can also be utilised as a "stick" to express dissatisfaction, such as with Norway when talks were suspended after the Nobel Peace Prize was awarded to Chinese dissident Liu Xiaobo.

The FTAs might also exert pressure on states to speed up economic talks or to counter other countries. After finalising negotiations with South Korea, there were hints there may be more pressure on Taiwan and Japan since both are competitors with Korea in terms of trade with China. Meanwhile, the FTAs with Iceland and Switzerland give them a competitive advantage in the EU (e.g., Credit Suisse estimates that in several years the pact might make China Switzerland's biggest trade partner instead of Germany). That might be seen as a kind of pressure on Brussels to launch FTA talks with China.

The Chinese FTAs may also help launch new diplomatic directions. Better relations with Reykjavik may help Beijing in the Arctic, a hot spot due to increased access to natural resources and transport routes. In 2013, Iceland supported China's bid for permanent observer status on the Arctic Council.

China's FTA negotiations with small European countries and EFTA members might be seen as a learning process for how to deal with developed economies. China lacks the negotiating experience needed in talks with the EU to provide it with more access to its market.

Finally, Chinese initiatives such as FTAAP and Beijing's pressure on its RCEP partners to conclude negotiations on time are attempts to provide an alternative to TPP and to take the initiative in economic integration in Asia.

PRC Economic Diplomacy and EU–China Ties. Under Xi's term, China has pursued proactive economic diplomacy. The establishment of the BRICS New Development Bank and Reserve Fund, establishment of "Silk Road" institutions, such as the Asian Infrastructure Investment Bank and Silk Road Fund, FTAAP, and new FTAs with developed economies are a few examples of China's rising influence in the global economy and readiness to set the worldwide economic agenda. Despite the shift to the FTA approach, the depth and scope of liberalisation under the Chinese versions is narrower than with other high-standard agreements. However, China's ambitions to be a rule-maker and its awareness that new large economic pacts may marginalise it and hamper its economic interests are becoming incentives to enact more ambitious agreements.

This should be a signal to the EU, which wants to further open China's economy, including an end to what it considers egregious treatment such as joint-venture requirements, obligatory technology transfers, state subsidies for domestic firms, IPR problems, and others. China's readiness to take on high-quality commitments, but mainly its TTIP concerns, might prompt Beijing to exert more pressure to launch FTA talks with the EU, though not necessarily with a focus on the Bilateral Investment Agreement (BIT), which the EU and China are negotiating now. But since the FTA talks are not on the table, the new EU leadership should put the emphasis on BIT as a prerequisite to any future FTA negotiations and engage China in other multilateral talks, such as the WTO Trade in Services Agreement (TISA) and Government Procurement Agreement (GPA) as a means to facilitate market access in China.