

# Regional Trade Agreements vs. Multilateral Trading System:

## A Study of Chinese Interests and Policy Options

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# Regional Trade Agreements vs. Multilateral Trading System:

## A Study of Chinese Interests and Policy Options

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**[Abstract]** The simultaneous emergence of rapidly developing RTAs and a strengthened and more encompassing MTS attracts worldwide attention. “Complementary Competition” is the very essence of the RTA/MTS relationship. Both compete complementarily in trade liberalization and economic integration initiatives. Since joining the WTO, China has pursued a “three-pronged” economic and trade development strategy of pushing forward regional trade cooperation and bilateral trade cooperation while enhancing multilateral trade and cooperation. After joining the WTO, China has basically developed a spatial landscape of “focusing on Asia-Pacific and reaching out globally” with regard to its participation in the RTA. By participating in RTAs, China can obtain the same benefits of market openness and trade and investment liberalization as other countries do. It is important for China not to act too hastily, but to push forward regional cooperation step by step from adjacent to remote regions and level by level, from easy to difficult regions. Asia is especially important to China, and Asian economic cooperation is the foundation of China’s RTA policy.

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# 1. Introduction\*

As an important exception to Article XXIV of GATT 1947 and Article V of GATS, Regional Trade Agreements (RTAs)<sup>1</sup> have been defined and stipulated in a highly general and ambiguous way. Taking the inaction of the multilateral trading system (MTS) towards RTAs as an encouragement, many WTO members have attached greater importance to trade within the region than that beyond. This has given rise to opportunism among those members who tend to disregard the rules of the WTO. Their observance of the rules often depends on how useful the rules are seen as being to their individual interests. In fact, RTAs have become an important reason why the WTO members are now less likely to agree on compromises in the Doha Development Agenda (DDA) negotiations.<sup>2</sup>

According to the WTO,<sup>3</sup> the surge in RTAs has continued unabated since the early 1990s (see Figure 1). As of December 2008, some 421 RTAs had been notified to GATT/WTO. Of these, 324 RTAs were notified under Article XXIV of GATT 1994; 29 under the Enabling Clause;<sup>4</sup> and 68 under Article V of the GATS. As of that same date, 230 agreements were in force. Taking into account RTAs that are in force but have not been notified, those signed but not yet in force,

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<sup>1</sup> A Regional Trade Agreement (RTA) is when two or more countries as sovereign states or regions as separate customs territories, seeking to pursue growth and economic and trade interests, reach a common government policy orientation through such forms as Preferential Trade Arrangement (PTA), Free Trade Agreement (FTA), Customs Union (CU), Common Market (CM), Economic Community (EC), and Economic Union (EU) so as to realize trade liberalization and to strengthen and regulate economic and technical cooperation within the region. In some cases, FTA is also called 'free trade area' in this article.

<sup>2</sup> In November 2001 Trade Ministers from 142 countries launched a new round of world trade negotiations at the 4th WTO Ministerial Conference, in Doha, Qatar. The work programme that was adopted (known as the Doha Development Agenda or DDA) envisaged a broad round of trade negotiations, centring on the needs and interests of developing countries. The DDA, which has been deadlocked since failure in Cancun, recovered its momentum when the July Package was adopted in August 2004. Since then, member countries have intensified negotiations in order to reduce gaps between the perspectives of the various countries. Although most attention has been focused on farm trade, non-agricultural market access, and services, the negotiators have been at loggerheads over how to free agricultural trade, and have made little progress on the liberalization of services and industrial goods. At present, DDA has been suspended without any timetable for conclusion.

<sup>3</sup> For facts and figures on RTAs notified to the WTO, see Regional trade agreement: facts and figures, available at < [www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm) > (accessed 17 February 2009).

<sup>4</sup> For more details concerning the Enabling Clause, see section 2.2.2.

those currently being negotiated, and those in the proposal stage, we arrive at a figure of close to 400 RTAs scheduled for implementation by 2010. Of these, FTA and partial scope agreements account for over 90%, while customs unions and other forms of RTAs account for less than 10 % (see Table 1).

A notable feature in the recent rise of regionalism is that countries that have traditionally favoured the multilateral approach to trade liberalization – including Australia, Japan, Singapore, India and the Republic of Korea – have joined the RTA bandwagon. A different composition of RTAs involving broader country coverage beyond the traditional regional zone has emerged, with RTAs between countries and entities in different regions/continents (e.g. EU–Mexico, EU–South Africa, US–Israel, Jordan, Morocco, and Chile). These agreements are generally bilateral in membership, concluded by two countries/entities, including the case of FTAs negotiated and concluded by two distinct RTAs (e.g. EU–MERCOSUR, currently under negotiation).

Often RTAs can actually support the MTS. Regional agreements have allowed groups of countries to negotiate rules and commitments that go beyond what would have been possible multilaterally. In turn, some of these rules have paved the way for agreement in the WTO. Services, intellectual property, environmental standards, investment and competition policies are all issues that were originally raised in regional negotiations and later developed into agreements or topics of discussion within the WTO.

The RTAs that are important for the WTO are those that abolish or reduce barriers on trade within the group. The WTO agreements recognize that regional arrangements and closer economic integration can benefit countries. In particular, RTAs should help trade flow more freely among the countries in the group, without barriers being raised to trade with the outside world. In other words, regional integration should complement the MTS and not threaten it. Further, compared with the MTS, RTA negotiations are easier, more specific and more flexible.<sup>5</sup> Such negotiations are more likely to achieve a win–win effect, as they can avoid dealing with thorny issues otherwise unavoidable in multilateral negotiations. Given these advantages, countries and regions can hardly be blamed for initiating regional trade cooperation, especially when the MTS has been suffering temporary setbacks.

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<sup>5</sup> For an analysis of some of the major benefits for countries entering into RTAs, see John Whalley, *Why do countries seek Regional Trade Agreements*, available at: <[www.nber.org/papers/w5552](http://www.nber.org/papers/w5552)> (accessed 17 February 2009). This paper emphasizes the range of factors which enter country calculations to seek RTAs. These include conventional access benefits as well as safe haven concerns, the use of trade arrangements to underpin security arrangements, and tactical interplay between multilateral and regional trade negotiating positions.

As a result, on the one hand, there is the undeniable fact that rapid development in regional trade cooperation has at least partly undermined the WTO members' mutual trust and belief in the MTS; on the other, fast-moving RTAs, as the prerequisite and basis for the MTS, can serve as a major driving force for the progress of the MTS. Thus, the two are not necessarily mutually incompatible or exclusive.

It is based on this consideration that this paper will focus on the relationship of "complementary competition" between RTAs and the MTS. We begin by examining the original provisions and further supplements of RTAs in the MTS, and then focus on analysing RTAs in China. The paper concludes by noting some strategic objectives and policy options for the future development of RTAs in China.





## 2. Regional Trade Agreements in the Multilateral Trading System: Original Provisions and Further Supplements

### 2.1 GATT 1947 Provisions for Regional Trade Agreements

RTAs have received extensive attention in the MTS because they are among the most important exceptions<sup>6</sup> to the multilateral General Most-Favoured-Nation (MFN) Treatment.<sup>7</sup> The intertwined developments of the MTS and RTAs over last six decades have revealed the basic legal relationship: WTO members entering into RTAs can be granted an exemption that relieves them of their MFN treatment obligations only after complying with the provisions of GATT 1947.<sup>8</sup>

#### 2.1.1 Purpose of RTAs

Article XXIV of GATT 1947 allows RTAs to operate as an exception to the MFN treatment principle, because the Contracting Parties recognize that GATT may further promote global economic integration and development and become a beneficial supplement to the MTS, provided that it does not constitute a threat to the economic and trade interests of the third countries other than regional groups. To that end, the purpose of RTAs is set forth in paragraph 4 of Article XXIV of GATT 1947, “*The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. The purpose of a customs union or of*

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<sup>6</sup> The exceptions in GATT 1947 are found mainly in Article XIV (Exceptions to the rule of Non-discrimination), Article XX (General Exceptions) and Article XXI (Security Exceptions). Available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm) > (accessed 17 February 2009).

<sup>7</sup> GATT 1947 Article I:1 (General Most-Favoured-Nation Treatment) provides that, “With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.” Available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm) > (assessed 17 February 2009).

<sup>8</sup> Won-Mog Choi, “Legal Problems of Making Regional Trade Agreements with Non-WTO-Member States,” *Journal of International Economic Law* (Vol.8, No.4, Dec 2005), p.825. The author provides a comprehensive interpretation of provisions in the WTO Agreement on the issue of RTAs involving non-WTO-member states, as well as analyzing various legal problems that may arise from entering into RTAs with non-WTO-member states; and proposes a policy direction compatible with WTO jurisprudence, to be referred to in concluding RTAs with non-WTO-member economies.

*a free trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.”*<sup>9</sup>

### 2.1.2 Characteristics of RTAs

The characteristics of RTAs are specified in paragraph 8 of Article XXIV of GATT 1947<sup>10</sup>, “*A customs union and a free trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories.*”

With respect to customs unions (CU), GATT 1947 also stipulates: “*subject to the provisions of paragraph 9*<sup>11</sup>, *substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.*”

However, it does not provide for the absolute elimination of any duties and other restrictive regulations of trade between the Contracting Parties, and allows for some flexibility in special circumstances. The constituent territories can, if necessary, continue to maintain the duties and other restrictive regulations set forth under Articles XI, XII, XIII, XIV, XV and XX of GATT 1947.<sup>12</sup>

### 2.1.3 Restrictive conditions of RTAs

Paragraph 5 of Article XXIV of GATT 1947<sup>13</sup> sets forth the restrictive conditions for the formation of an RTA to avoid any adverse impact on the trade with third countries.

<sup>9</sup> GATT1947 Article XXIV: 4, available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt4702\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt4702_e.htm) > (accessed 17 February 2009).

<sup>10</sup> GATT1947 Article XXIV: 8, available at :< [www.wto.org/english/docse/legale/gatt4702e.htm](http://www.wto.org/english/docse/legale/gatt4702e.htm) > (accessed 17 February 2009).

<sup>11</sup> According to paragraph 9 of Article XXIV, the preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected. This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a)(i) and paragraph 8 (b). Available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

<sup>12</sup> Articles XI, XII, XIII, XIV, XV and XX respectively refer to “General Elimination of Quantitative Restrictions”, “Restrictions to Safeguard the Balance of Payments”, “Non-discriminatory Administration of Quantitative Restrictions”, “Exceptions to the Rule of Non-discrimination”, “Exchange Arrangements” and “General Exceptions” in the GATT1947, available at

:< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

<sup>13</sup> GATT1947 Article XXIV: 5, available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

With respect to a CU or an FTA, or an interim agreement leading to the formation of such, “*the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement.*”<sup>14</sup>

Such an interim agreement shall “*include a plan and schedule for the formation of such a customs union or of such a free trade area within a reasonable length of time.*”<sup>15</sup>

If, in fulfilling the requirements of the above, a Contracting Party proposes to increase any rate of duty in a manner inconsistent with the provisions of Article II of GATT 1947<sup>16</sup>, the procedure set forth in Article XXVIII<sup>17</sup> shall apply. In providing for compensatory adjustment, due account shall “*be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.*”<sup>18</sup>

In addition to the above restrictive conditions, paragraph 7 of Article XXIV of GATT 1947 provides for “transparency on the formation of a regional trade agreement”. Any Contracting Party deciding to enter into a CU or FTA, or an interim agreement leading to the formation of such a union or area, “*shall promptly notify the Contracting Parties*” and “*shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.*”<sup>19</sup>

Furthermore, paragraph 10 of Article XXIV of GATT 1947 also provides for the decision-making procedures to approve a CU or FTA. The Contracting Parties “*may by a two-thirds majority approve pro-*

<sup>14</sup> GATT 1947 Article XXIV: 5(a) and (b), available at :< > (accessed 17 February 2009).

<sup>15</sup> GATT1947 Article XXIV: 5(c), available at:

:< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

<sup>16</sup> Article II refers to Schedules of Concessions annexed to and hereby made as an integral part of Part I of GATT1947, available at :< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm) > (accessed 17 February 2009).

<sup>17</sup> Article XXVIII( Modification of Schedules) provides that, a contracting party may, by negotiation and agreement with any contracting party with which such concession was initially negotiated and with any other contracting party determined by the contracting parties to have a principal supplying interest, and subject to consultation with any other contracting party determined by the contracting party to have a substantial interest in such concession, modify or withdraw a concession\* included in the appropriate schedule annexed to the GATT1947. Available at:

:< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

<sup>18</sup> GATT1947 Article XXIV: 6, available at

:< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

<sup>19</sup> GATT1947 Article XXIV: 7(a), (b), (c), available at:

< [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

*posals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.”<sup>20</sup>*

## **2.2 RTA Coverage and Enabling Clause for developing countries**

In the WTO context, RTAs have both a more general and a more specific meaning: more general, because RTAs may be agreements concluded between countries not necessarily belonging to the same geographical region; more specific, because of the WTO provisions which relate specifically to conditions of preferential trade liberalization with RTAs. Moreover, in favour of the developing countries, the Enabling Clause also allows derogations to the MFN treatment and provides the WTO legal basis for regional arrangements among developing countries.

### **2.2.1 RTA coverage**

By their very nature, RTAs are discriminatory: they represent a departure from the MFN principle, which in turn is a cornerstone of the MTS. Their effects on global trade liberalization and economic growth are not clear, since the regional economic impact of RTAs is inherently ambiguous. Although RTAs are designed to the advantage of signatory countries, expected benefits may be undercut if distortions in resource allocation, as well as the trade and investment diversion potentially present in any RTA process, are not minimized or indeed eliminated altogether. The net economic impact of any given RTA will depend on its own architecture and the choice of its major internal parameters, in particular the depth of trade liberalization and sectoral coverage.

From a legal perspective, the requirement established in Article XXIV of GATT 1947 that barriers to trade should be eliminated on “substantially all trade” indicates that the sectoral coverage of the liberalization effort should be extensive. Most likely, the requirement as to the depth and extent of trade liberalization was aimed at limiting the proliferation of RTAs, avoiding agreements that were formed with the intent to create sectorally discriminatory arrangements. However, Article XXIV fails to define the precise extent of the product coverage required. Similarly, Article V of the GATS requires that an economic integration agreement must have “substantial sectoral coverage” of the trade in services among the parties. A footnote clarifies that this requirement should be “understood in terms of number of sectors, vol-

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<sup>20</sup> GATT 1947 Article XXIV: 10, available at  
: < [www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_02\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm) > (accessed 17 February 2009).

ume of trade affected and of the four modes of supply”. But the extent of the sectoral coverage required remains unresolved.

The coverage and depth of preferential treatment vary from one RTA to another. Modern RTAs, and not exclusively those linking the most developed economies, tend to go far beyond tariff-cutting exercises. They provide for increasingly complex regulations governing intra-trade (with respect to standards, safeguard provisions, customs administration, etc.) and they often also provide for a preferential regulatory framework for trade in mutual services. The most sophisticated RTAs go beyond traditional trade policy mechanisms, to include regional rules on investment, competition, the environment and labour.

With the number of RTAs increasing, the coexistence in a single country of differing trade rules applying to different RTA partners has become a frequent feature. This can hamper trade flows by the sheer costs involved for traders in meeting multiple sets of trade rules. Especially as their scope broadens to include policy areas not regulated multilaterally, the proliferation of RTAs increases the risks of inconsistencies in the rules and procedures among RTAs themselves, and between RTAs and the multilateral framework. This is likely to give rise to regulatory confusion, distortion of regional markets, and severe implementation problems, especially where there are overlapping RTAs.

### **2.2.2 The Enabling Clause for developing countries**

The Enabling Clause (officially: the “Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries”) was adopted under GATT in 1979. It enables developed members to accord differential and more favourable treatment to developing countries. In particular, it refers to RTAs between developing-country members; its paragraph 2(c) permits preferential arrangements among developing countries in trade in goods. It can be argued that the Enabling Clause sets less stringent requirements than those contained in GATT Article XXIV. Indeed, several South–South RTAs have been notified under the Enabling Clause.<sup>21</sup>

According to paragraph 2(c), the Decision applies to “*Regional or global arrangements entered into amongst less-developed Contracting Parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of*

<sup>21</sup> South–South RTAs notified under the Enabling Clause include the India–Sri Lanka FTA, EAC, CEMAC, SAPTA, AFTA, CAN, COMESA, ECO, MERCOSUR, Laos–Thailand, GCC, LAIA, PTN, GSTP, TRIPARTITE Agreement, and UEMOA. Available at :<[www.wto.org/english/tratop\\_e/region\\_e/provision\\_e.xls](http://www.wto.org/english/tratop_e/region_e/provision_e.xls)> (accessed 25 May 2009).

*non-tariff measures, on products imported from one another.”*<sup>22</sup> The Enabling Clause also sets some restrictive conditions for the formation of RTAs between developing-country members, conditions similar to those in paragraph 5 of Article XXIV of GATT 1947. Paragraph 3 provides that any differential and more favourable treatment provided under this Clause: “*shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties; shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a MFN basis; shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.*”<sup>23</sup>

### 2.3 Further Supplements to GATT 1947 for RTAs

Based on the final results of the Uruguay Round, the WTO separates the trade in goods from the trade in services for any issues involving the RTA. With regard to trade in goods, the WTO passed the Understanding on the Interpretation of Article XXIV of GATT 1994 (“Understanding”), while retaining Article XXIV of GATT 1947. With regard to trade in services, Article V of the General Agreement on Trade in Services (GATS) contains provisions similar to those of Article XXIV of GATT 1947 with respect to RTAs. According to the authorization of the Doha Ministerial Declaration,<sup>24</sup> RTAs are among the important issues of the DDA negotiations.

#### 2.3.1 Paragraph 5, Article XXIV of GATT 1947 by way of “Understanding”

The evaluation under paragraph 5 of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a CU shall “*in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected*”.<sup>25</sup>

<sup>22</sup> Text of the 1979 GATT decision on differential and more favorable treatment reciprocity and fuller participation of developing countries, available at :< [www.wto.org/english/docs\\_e/legal\\_e/enabling1979\\_e.htm](http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm)> (accessed 9 May 2009).

<sup>23</sup> See note 22 above.

<sup>24</sup> DOHA WTO MINISTERIAL 2001: Ministerial Declaration adopted on 14 November 2001, available at :< [www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm)> (accessed 17 February 2009). Paragraph 29 states that the negotiations aim at clarifying and improving disciplines and procedures under the existing WTO provisions and the negotiations also shall take into account the developmental aspects of the RTAs.

<sup>25</sup> Paragraph 2 of the Understanding on the Interpretation of Article XXIV of GATT 1994, available at :< [www.wto.org/english/docs\\_e/legal\\_e/10-24\\_e.htm](http://www.wto.org/english/docs_e/legal_e/10-24_e.htm)> (accessed 17 February 2009).

It is also recognized by the WTO members that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, “*the examination of individual measures, regulations, products covered and trade flows affected may be required.*”<sup>26</sup>

The “reasonable length of time” referred to in paragraph 5 of Article XXIV should “exceed 10 years only in exceptional cases”.<sup>27</sup> If the Contracting Parties to an interim agreement believe that 10 years would be insufficient, they must provide a full explanation to the Council for Trade in Goods of the need for a longer period.

### **2.3.2 Paragraph 7, Article XXIV of the GATT1947 by way of “Understanding”**

All notifications made under paragraph 7 of Article XXIV shall “*be examined by a working party in the light of the relevant provisions of GATT 1994 and of paragraph 1 of this Understanding.*”<sup>28</sup> The working party shall submit a report to the Council for Trade in Goods on its findings in this regard. The Council may make such recommendations to the WTO members as it deems appropriate.

Customs unions and constituents of free trade areas are also to “report periodically”<sup>29</sup> to the Council for Trade in Goods, as envisaged by the Contracting Parties to GATT 1947 in their instruction to the GATT 1947 Council concerning reports on regional agreements, on the operation of the relevant agreement. Any significant changes and/or developments in the agreements should be reported as they occur.

### **2.3.3 RTAs in GATS Article V**

Under paragraph 1 of Article V, GATS shall “*not prevent any of its members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement*”.<sup>30</sup>

However, any agreement referred to in paragraph 1 shall be designed to facilitate trade between the parties to the agreement. It must not, in

<sup>26</sup> See note 24 above.

<sup>27</sup> Paragraph 3 of the Understanding on the Interpretation of Article XXIV of GATT1994, available at :< [www.wto.org/english/docs\\_e/legal\\_e/10-24\\_e.htm](http://www.wto.org/english/docs_e/legal_e/10-24_e.htm)> (accessed 17 February 2009).

<sup>28</sup> Regarding the Review of Customs Unions and Free-Trade Areas, see Paragraph 7 to 11 of the Understanding on the Interpretation of Article XXIV of GATT 1994, available at: < [www.wto.org/english/docs\\_e/legal\\_e/10-24\\_e.htm](http://www.wto.org/english/docs_e/legal_e/10-24_e.htm)> (accessed 17 February 009).

<sup>29</sup> Paragraph 11 of the Understanding on the Interpretation of Article XXIV of GATT 1994, available at :< [www.wto.org/english/docs\\_e/legal\\_e/10-24\\_e.htm](http://www.wto.org/english/docs_e/legal_e/10-24_e.htm)> (accessed 17 February 2009).

<sup>30</sup> GATS Article V 5(1), available at :<[www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm)> (accessed 17 February 2009).

respect of any member outside the agreement raise, the overall level of barriers to trade in services within the respective sectors or sub-sectors compared to the level applicable prior to such an agreement.

In addition, a service supplier of any other member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall *“be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.”*<sup>31</sup>

Regarding the modification of schedules, paragraph 5 of Article V prescribes that, if, in the conclusion, enlargement or any significant modification of any RTA agreement under paragraph 1, a WTO member intends to withdraw or modify a specific commitment in a way inconsistent with the terms and conditions set out in its Schedule, it *“shall provide at least 90 days advance notice of such modification or withdrawal and the procedure set forth in paragraphs 2, 3 and 4 of Article XXI shall apply.”*<sup>32</sup>

Provisions for the notification obligation and periodic reporting system are set forth in paragraph 7, Article 5 of GATS. The WTO members which are parties to the RTA shall *“promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services.”*<sup>33</sup> The WTO members shall also make available to the Council such relevant information as may be requested. The Council may establish a working party to examine such an agreement or enlargement or modification of that agreement and to report to the Council on its consistency with this Article.

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<sup>31</sup> GATS Article V 5(6), available at :<[www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm)> (accessed 17 February 2009). No similar requirements are provided in Article XXIV of GATT 1947. Fully recognizing the characteristics of trade in services, GATS sets forth more objective and equitable provisions on the interests of any service exporters of the third countries and makes a positive step forward in restricting discriminatory practice, resisting protectionism in the area of trade in services and reducing the diverting effects of RTAs.

<sup>32</sup> GATS Article V 5(5), available at :<[www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm)> (accessed 17 February 2009).

<sup>33</sup> GATS Article V 5(7), available at :<[www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm)> (accessed 17 February 2009).



# 3. The Relation of the Regional Trade Agreement and the Multilateral Trading System: Traditional Approach and New Definition

## 3.1 Traditional Approach

The simultaneous emergence of rapidly developing RTAs and a strengthened and more encompassing MTS attracts worldwide attention. Negotiating and benefiting from RTAs requires important human and institutional resources and infrastructures and resolving underlying asymmetries, including asymmetries with respect to size and economic conditions. This new interface between multilateralism and regionalism in terms of coherence and compatibility deserves special attention on the part of policy makers and requires careful and in-depth study. Naturally, the WTO is concerned about the rise and unprecedented development of RTAs, and their impact on its credibility and authority.

In the context of Singapore Ministerial Declaration adopted on 13 December 1996, the WTO adopts a tolerant attitude towards RTAs. As noted in paragraph 7: “*Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system.*”

<sup>34</sup>Thus, the WTO has acknowledged the compatibility between RTAs and the MTS. Ignoring or denying the “objective connection” and thereby weakening the basic legal relationship and further rejecting the positive impacts and effects between them would not only run contrary to the objective reality of RTAs today: it would also frustrates MTS efforts strengthen and improve supervision and coordination for the formation and development of RTAs. Various analytical arguments have been applied in dealing with this question.<sup>35</sup>

One approach widely used is to examine potential effects of the formation of RTAs on trade polices of their members and on those of

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<sup>34</sup> SINGAPORE WTO MINISTERIAL 1996: Ministerial Declaration, Adopted on 13 December 1996, available at :<[www.wto.org/english/thewto\\_e/minist\\_e/min96\\_e/wtodec\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm)> (accessed 18 February 2009). Paragraph 7 states that the expansion and extent of regional trade agreements make it important to analyze whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified.

<sup>35</sup> For the historical arguments and aspects of WTO members’ attitudes towards the RTA. See James H. Mathis, *Regional Trade Agreements in the GATT/WTO*, TMC Asser Press, 2002.

third countries. As yet, no clear conclusion has been reached that the formation of an RTA necessarily leads to more restrictive and protectionist policies on the part of its members.<sup>36</sup> Since the 1990s, the RTAs concluded by developing and developed countries – in America, Asia, or even on the African continent – have been linked to the adoption of economic deregulation measures (liberalization or privatization) and outward-oriented trade policies, rather than the concern for and pursuit of preferential treatment.<sup>37</sup> These past and new developments strongly indicate that the objectives of RTAs and the MTS initiatives are increasingly coinciding.

Another frequently used approach is to examine whether RTAs pave the way to a more liberalized world trade than the MTS.<sup>38</sup> It has been argued that consensus on trade liberalization more readily arrived at among a small group of like-minded countries than among a great number of WTO members – that RTAs can put an end to the “free-riding” problem inherent in multilateral process tariff-cutting exercises, whereby market-opening reductions in MFN tariff cuts are extended and applied unconditionally to all trading partners.

Superficially, this approach may seem plausible. However it overlooks at least three important aspects of the trade relations of WTO members. First, the requirement established in Article XXIV that barriers to trade should be eliminated on “substantially all trade” indicates that the sectoral coverage of the liberalization effort should be extensive. On the whole, liberalization has been much more ambitious in RTAs. In most of these agreements, the objective is to achieve reciprocal free trade in merchandise goods, a goal more ambitious than the “substantial reduction of tariffs and other barriers to trade” expressed in the

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<sup>36</sup> Hudgins Edward L., “Regional and multilateral trade agreements: Complementary means to open markets,” *Cato Journal* (Vol. 15, No. 2–3, Fall 1995/Winter 1996), p.231. Wherein, the author has concluded that, bilateral or regional trade agreements that simply remove tariffs and traditional trade barriers are generally acceptable even if they divert some trade. First, such agreements increase economic freedom. Second, they actually hold less danger of being a vehicle for the export of failed regulatory policies. Third, it is difficult to determine before the fact what arrangements will be more trade diverting in the long term than the status quo.

<sup>37</sup> Kimberly A. Clausing, “Trade Creation and Trade Diversion in the Canada–United States Free Trade Agreement,” *Canadian Journal of Economics* (Vol. 34, No. 3, Aug 2001), p. 677. In this paper, the changes in trade patterns introduced by the Canada–United States FTA are examined. Variation in the extent of tariff liberalization under the agreement is used to identify the impact of tariff liberalization on the growth of trade with member countries and non-member countries alike. The results indicate that the Canada–United States Free Trade Agreement has had substantial trade-creation effects, with little evidence of trade diversion. In addition, there was little evidence of trade diversion from non-member countries.

<sup>38</sup> Athanasios Vamvakidis, “Regional trade agreements or broad liberalization: Which path leads to faster growth?” *IMF Staff Papers* (Vol. 46, No.1, Mar 1999), p 42. Based on time-series evidence for a data set for 1950–1992, the author estimated and compared the growth performance of countries that liberalized broadly and that of those that joined an RTA. The comparisons show that economies grew faster after broad liberalization, in both the short and the long run, but slower after participation in an RTA. Economies also had higher investment shares after broad liberalization, but lower ones after joining an RTA. The policy implications thus support broad liberalization.

WTO Agreement. However, RTAs may differ greatly as to the set of products eligible for preferential treatment, the margin of preference granted on each product, the pace of tariff reduction and the level of the MFN barrier of RTA members against third parties. All these elements are essential determinants of the overall extent of preferential market access granted by a RTA, its economic effects and the degree of compatibility with the MTS. The available empirical evidence suggests that there is substantive elimination of merchandise trade barriers, but sensitive sectors such as agriculture and textiles and clothing are important exceptions.<sup>39 40</sup> It is also less clear how effectively services barriers are being eliminated in RTAs. Roy et al. (2006) reviewed the services commitments in 28 RTAs and found,<sup>41</sup> the most protected services activities in larger, especially developed countries, remain, despite some improvements on the fringes, largely unaffected by RTAs, e.g., audiovisual for EFTA<sup>42</sup> and the EC, maritime transport and certain professional services for the US, and cross-border trade in a number of financial services for a variety of countries. While most of the largest countries have become involved in services RTAs, they do not have RTAs amongst themselves (i.e., China, US, Japan, EC, India). To this day, the multilateral system still remains the main avenue for these countries for resolving services trade issues and negotiating future disciplines. The WTO also examined the trade contingent measures in 74 RTAs, which varied in size, degree of integration, geographic region and the level of economic development of their members. A few of RTAs have achieved abolition of trade contingent measures provided in the multilateral system,<sup>43</sup> including the largest RTA, e.g. the European Communities.

<sup>39</sup> The WTO Secretariat (2002) conducted an analysis of some 47 RTAs, mostly arrangements involving the EC, EFTA and CEFTA. It found that the agreements resulted in the elimination of most, if not all, duties on industrial goods either on the date of entry into force of the agreement or during the transition period of the agreement. The goal of free trade in industrial products appeared to be the accepted norm. However, agricultural trade remained subject to exceptions, with average agricultural preferential tariffs remaining high and tariff peaks quite prominent.

<sup>40</sup> A more recent study by the Inter-American Development Bank (IADB) (2006) involved 20 RTAs, primarily in Latin America and the Asia-Pacific region. The study found that most of the RTAs eliminated duties on at least 90 per cent of their imports from RTA partners by the 10th year of implementation of the agreement. But there are important caveats to this conclusion. Products such as agriculture and textiles and clothing, which have historically been difficult to liberalize at the multilateral level, also appeared to encounter significant problems in RTAs. In RTAs, the transition period for completely removing tariffs on these products is significantly longer (sometimes 20 years) than for other goods.

<sup>41</sup> Martin Roy, Juan Marchetti, Hoe Lim, "Services Liberalization in the New Generation of Preferential Trade Agreements (PTAs): How Much Further than the GATS?", WTO Staff Working Paper ERSD-2006-07, September 2006.

<sup>42</sup> EFTA refers to European Free Trade Association. EFTA comprises 4 countries: Iceland, Liechtenstein, Norway, and Switzerland.

<sup>43</sup> At the multilateral level, the most important contingency provisions are to be found in GATT Articles VI (Anti-dumping and Countervailing Duties) and XIX (Emergency Action on Imports of Particular Products) and the corresponding multilateral agreements - Anti-Dumping Agreement, Subsidies and Countervailing Measures Agreement and the Agreement on Safeguards.

Second, the “single undertaking”<sup>44</sup> approach adopted by the Uruguay Round negotiators resolved to a substantial extent the issue of free-riding in the system, when viewed in the broader context of non-tariff measures.

Third, the WTO members maintain trade and economic relations with a wider group of partners than are covered by regional agreements. The global coverage of the WTO rules is an inherent advantage over a regional integration agreement covering only a sub-group of trading partners.

How has the MTS dealt with regionalism? How have the provisions of GATT Article XXIV been implemented over the years? By the time the Uruguay Round negotiations got underway (1986–1994), the “second wave” of regionalism had begun. The catalytic event was the creation of the US–Canada FTA (1989), prefigured nearly four decades earlier. For many, this was a momentous occasion that reflected a fundamental shift in US priorities, from multilateralism to regionalism. Hence the negotiations included efforts at strengthening multilateral disciplines on RTAs.

The Uruguay Round produced the Understanding on the Interpretation of Article XXIV of GATT 1994. This document seeks to clarify the criteria and procedures for the assessment of new or enlarged agreements and to improve the transparency of notified agreements. After the WTO was created in 1995, the Committee on Regional Trade Agreements (CRTA) was established to carry out the examination function, mandated to assess the compliance of the various regional trade agreements with the relevant WTO rule and to consider the implications for the MTS. As of 1 March 2007, more than half of the 194 notified RTAs had either been examined or were in the process of being examined. Fourteen were under factual examination; the factual examination of 62 RTAs had been concluded; the reports for 5 RTAs were under consultation; and 19 RTA examination reports had been adopted.<sup>45</sup> However, due to questions on the interpretation of the provisions contained in Article XXIV, members have not reached consensus or finalized any of the examinations of the CRTA.

Given the synchronization of the current proliferation and development of RTAs with the momentum and latest enhancing of the MTS after the Uruguay Round, the MTS and RTAs constitute a “simultane-

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<sup>44</sup> Single undertaking is one of the principles for organization and management of the negotiations in the WTO. It means that every item of the negotiation is virtually part of a whole and indivisible package and cannot be agreed separately. “Nothing is agreed until everything is agreed.”

<sup>45</sup> World Trade Report 2007, Six decades of multilateral trade cooperation: What have we learnt? P306, Dec.2007.

ity”, challenging the traditional “wax and wane” approach which holds that the MTS grows strongly as RTAs decline, and vice versa.<sup>46</sup> The implications of this “wax and wane” theorem have led to arguments about the relationship between RTAs and the MTS being “alternative rather than complementary”, “competing rather than complementary” and “competition over complementarities”, among others.

### **3.2 Progress on the relation of RTAs and the MTS in DDA negotiations**

Faced with the clear difficulties in the surveillance function of the WTO and concerned by the increasing number of RTAs, in Doha the multilateral effort at providing better oversight of RTAs continued. In the context of Doha Ministerial Declaration adopted on 14 November 2001,<sup>47</sup> the WTO members agreed to negotiate a solution, giving due regard to the role that RTAs can play in promoting the liberalization and expansion of trade and in fostering development. The WTO members have also stressed their commitment to the WTO as the unique forum for global trade rule-making and liberalization.

Proposals submitted by the WTO members to the Negotiating Group on Rules indicate that they have paid special attention to the following issues: 1) clarifying the existing RTA legal framework: WTO members entering into an RTA must meet the conditions set forth in Article XXIV of GATT 1947 and GATS Article 5 to ensure that no RTA causes any negative impacts on the MTS; 2) relations between regionalism and multilateralism. Most WTO members think that the RTA should be a forceful supplement and auxiliary means for the MTS, rather than a competitor. The relation between the two should be one of mutual complementarities rather than mutual confrontation. While using RTAs to promote trade development, WTO members are not to compromise the rules of the MTS. The increasingly numerous and complex RTAs shall not harm the effective operation and healthy development of the MTS.

RTA negotiations fall into the general timetable established for virtually all negotiations under the Doha Declaration. However, the original deadline of 1 January 2005 was missed. On 14 December 2006, the General Council established on a provisional basis a new transpar-

<sup>46</sup> Matthew Schaefer, “Ensuring that Regional Trade Agreements Complement the WTO System: US Unilateralism a Supplement to WTO Initiatives?” *Journal of International Economic Law* (Vol.10, No.3, Sep 2007), p.585. Schaefer holds that enhanced and extended efforts by the USA, either unilaterally or in conjunction with its RTA partners utilizing its negotiating leverage, may be a necessary supplement to efforts within the WTO in ensuring a more harmonious relationship between RTAs and the WTO system.

<sup>47</sup> See note 24 above.

ency mechanism for all RTAs.<sup>48</sup> The new transparency mechanism provides for early announcement of any RTA and notification to the WTO, whose members will consider the notified RTAs on the basis of a factual presentation by the WTO Secretariat. The Committee on Regional Trade Agreements will consider RTAs falling under Article XXIV of GATT 1994 and Article V of GATS, while the Committee on Trade and Development will consider RTAs falling under the Enabling Clause. The transparency mechanism is to be implemented on a provisional basis. WTO members are to review and if necessary modify the decision, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round.

### 3.3 “Complementary Competition” between RTAs and the MTS: New Definition

“Complementary Competition” is the very essence of the RTA/MTS relationship. Both compete complementarily in trade liberalization and economic integration initiatives, as a result of a “synergism” between regional-process trade negotiations and the multilateral-process trade negotiations seeking more open trade and markets.

Based on “Complementary Competition”, RTAs – which are able to make good use of their own unique qualities and special advantages like “like-mindedness”, “political and social homogeneities” and “effect of instant and direct *quid pro quo* of market-opening for market-opening”, – can serve as the “pilot bases” and “laboratories” for exploring and exploiting trade liberalization in new and sensitive products and sectors. Developing countries have adopted RTAs as the nucleus of national development strategies for their progressive and strategic integration into the world economy. Political economic models of trade support this view. A government may lack the political support necessary to pursue a global free trade policy – but it may be able to achieve this goal after joining a RTA. Ethier (1998) argues<sup>49</sup> that RTAs may help a government to mobilize domestic forces in support for the MTS through enhanced FDI. Suppose that the government of a country that has not yet acceded to the WTO is convinced of the need for economic reform and of joining the MTS. However, it faces political opposition to both courses of action. By initially entering into a preferential trade arrangement with a developed country, the reform-

<sup>48</sup> Text of the 2006 General Council Decision on Transparency Mechanism for regional trade agreements, Decision of 14 December 2006, available at: <[www.wto.org/english/tratop\\_e/region\\_e/trans\\_mecha\\_e.htm](http://www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm)> (accessed 18 February 2009).

<sup>49</sup> Wilfred J. Ethier, in “Regionalism in a Multilateral World”, *Journal of Political Economy* (Vol. 106, No. 6, Dec 1998), pp.1214–1245, describes an alternative model. The analysis suggests that regional integration, far from threatening multilateral liberalism, may in fact be a direct consequence of the success of past multilateralism and an added guarantee for its survival.

ing country would be able to attract FDI from its RTA partner and from other foreign investors, because of its access to the market of its RTA partner. These gains can tilt the political balance within the country in favour of economic reform and accession to the WTO and subsequently allow the government to proceed on both fronts.

Conversely, the MTS has gone further than the RTA in several areas, complementing the process of regional liberalization and extending those disciplines across all current and future trading partners on a global basis. Ethier (1998) argues that the new regionalism is, in good part, a direct result of the success of multilateral liberalisation.<sup>50</sup> Since RTA membership is considerably smaller than that of the WTO, less is required when it comes to internal transparency. Except for the largest RTAs, such as the EC or NAFTA, there appears to be no equivalent effort to engage civil society groups and the general public by providing access to official documents or events. Moreover, in the expanse and reach of its mandate, the WTO legislates and adjudicates in areas that go beyond border measures, covering tariffs and non-tariff barriers to trade, and extending into the areas of services and intellectual property rights. Many WTO agreements take the organization into areas that have traditionally fallen within the domestic jurisdictions of states. The Doha Round, eventually launched in Doha in November 2001, encompassed a wider range of negotiating issues and a work program that included market access in agriculture and manufactured goods, trade in services, TRIPS, trade and investment, trade and competition, transparency and government procurement, trade facilitation, WTO rules, dispute settlement, trade and environment, electronic commerce, small economies, trade, debt and finance, transfer of technology, special and differential treatment, and implementation-related issues and concerns.

More importantly, the WTO has also been provided with a strengthened dispute settlement system<sup>51</sup> as well as a monitoring and surveillance function.<sup>52</sup> Together these should bring increased transparency and predictability to trade and economic policies. Consequently, constituent members of RTAs have ensured, concurrently by virtue of be-

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<sup>50</sup> Wilfred J. Ethier, "The New Regionalism", *Economic Journal* (Vol. 108, No. 449, Jul 1998), pp1149–1161. Here the author focuses on appropriate models of the new regionalism, models in which regionalism might emerge as a consequence of past multilateral success and extensive current reform attempts.

<sup>51</sup> Dispute settlement is the central pillar of the multilateral trading system, and the WTO's unique contribution to the stability of the global economy. The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore for ensuring that trade flows smoothly. Without a means of settling disputes, the rules-based system would be less effective because the rules could not be enforced.

<sup>52</sup> Surveillance of national trade policies is a fundamental activity in the work of the WTO. At the centre of this work is the Trade Policy Review Mechanism (TPRM). All WTO members are reviewed, the frequency of each country's review varying according to its share of world trade.

ing members of the WTO, the adoption of an enhanced set of policies and procedures for their own trade and economic relations.

In order to maintain their respective unique merits, momentum, credibility and authority, regionally and multilaterally, the RTA and the MTS also compete with each other in trade liberalization and economic integration, and presumably, transitionally in human resources and political attention as well. Following a transition period, the competition as such is likely to be transformed into a complementary situation in which the RTA and the MTS absorb each other's good experiences and achievements. Thereafter, the complementarities are likely to be progressively transformed into new competition, with the RTA and the MTS racing against one another, seeking more and freer trade. According to Jeongwook Suh (2004),<sup>53</sup> by accelerating the liberalization of multilateral trade, the WTO contributes to directing regionalism to serve as a building block rather than a stumbling block to free trade.

In this way, there will be a "virtuous circle" forming in the RTA/MTS relationship, within which the situations of competition and complementarities are dynamically and qualitatively transformed. It is precisely this mutual transformation of competition and complementarities that can inject new energy and vitality into the process of multilateral trade liberalization on which global economic integration will finally be realized.

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<sup>53</sup> Jeongwook Suh, "The Relationship between Regionalism and Multilateralism: A Case Study of the Korean Computer Industry," *Journal of the Korean Geographical Society* (Vol.39, No.2, 2004), p. 256.



## 4. China and RTAs: Current Situation and Motivated Interests

### 4.1 Development of China's RTA Participation

China is a strong powerhouse with considerable international influence. In terms of population, resources, economic size and position in international politics and economy, China plays a pivotal role in the world economic and political arena. Since joining the WTO,<sup>54</sup> China has pursued a “three-pronged” economic and trade development strategy of pushing forward regional trade cooperation and bilateral trade cooperation while enhancing multilateral trade and cooperation. In 2001, in its 10th Five-Year Plan,<sup>55</sup> for the first time, China expressly mentioned “actively participating in the multilateral trade system and regional economic cooperation” as an important means to promote its opening to the outside world.

China began to participate in regional economic cooperation during the negotiation process for WTO accession, and especially after its accession. China and ASEAN<sup>56</sup> started FTA negotiations in November 2001. If such negotiations are taken as the starting point of RTA participation, China has pursued regional cooperation for only 7 years. It is therefore fair to say that China is still an elementary school pupil in respect of participation in RTAs.

The ways by which China participates in regional economic cooperation can be divided into three categories (see Table 1): i) participating in regional cooperation under a specific mechanism; ii) participating in regional cooperation of forum nature; iii) participating in substantially preferential trade agreements. FTAs have become the most important way by which China participates in RTAs.

On 4 November 2002, China and ASEAN entered into a Framework Agreement on Comprehensive Economic Cooperation, setting the ba-

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<sup>54</sup> China joined the WTO in December 2001. In recent years, China has established an image for itself as a “committed, responsible and credible” country through exerted effort and good practices. China’s successful economic development has jump-started a new era of opening to the outside world. Its WTO accession has generated positive effects, with “reciprocal benefits and win-win solutions” for China and the world.

<sup>55</sup> Outline of the Tenth Five-Year Plan for National Economic and Social Development of the PRC, adopted on 15th March 2001. Available at: <[news.xinhuanet.com/zhengfu/2001-10/18/content\\_51471.htm](http://news.xinhuanet.com/zhengfu/2001-10/18/content_51471.htm)>(accessed on 19 February 2009).

<sup>56</sup> ASEAN refers to Association of South East Asian Nations. ASEAN comprises 10 countries: Indonesia, Laos, Brunei, Burma, Cambodia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

sis framework for the ASEAN-China Free Trade Area (ACFTA). ACFTA was the first FTA to be established between China and other countries. The Agreement on Trade in Goods took effect on 20 July 2005, marking the entry of ACFTA construction into the comprehensive and substantive operation stage.

On 29 June 2003, Mainland China entered into the Closer Economic Partnership Arrangement (CEPA) with the governments of the Special Administrative Regions of Hong Kong and Macau (with five Supplementary Agreements signed during 2004–2008). CEPA represents the successful application of the “one country, two systems” principle and a new path of systematic cooperation between Mainland and Hong Kong/Macau, not least in economic and trade exchange. In addition, it is the FTA entered into between China as a sovereign state and Hong Kong and Macau each as a separate customs territory, and is the first FTA implemented by Mainland China.

Altogether, by the end of 2008, there were 14 FTA agreements for which China had completed negotiations or had been conducting negotiations with other countries or regions.<sup>57</sup> These FTA agreements involve 29 countries and regions (see Table 3) and account for one-fourth of China’s foreign trade (see Table 4). Among them, there are 6 FTA agreements that have been in force and are well implemented. FTAs have now become a new starting point after China’s accession to the WTO: a new platform and method of promoting reform, development, win–win and harmony by opening further to the outside world.

#### **4.2 Main Features of China’s RTA Participation**

When economic diplomacy becomes an important part of politic diplomacy, the participation of a country in RTAs cannot be separated from its diplomatic strategy. China’s diplomatic policy is to accord top priority to neighbouring regions while also paying attention to its relations with superpowers and developing countries. After joining the WTO, China has basically developed a spatial landscape of “focusing on Asia-Pacific and reaching out globally” with regard to its participation in the RTA.

In financial terms, the trade between China and its Asian neighbours makes up over 60% of China’s foreign trade, so establishing FTAs with these neighbouring countries is a highly rapid and effective economic strategy. China’s regional cooperation plan is in fact becoming an important driving force behind Asian economic integration. Exam-

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<sup>57</sup> Available at :< [fta.mofcom.gov.cn](http://fta.mofcom.gov.cn) > (accessed on 19 February 2009).

ining the FTAs that China is attempting to build in Southeast Asia (with ASEAN), Northeast Asia (with Japan and Korea), Central Asia (with Shanghai Cooperation Organization)<sup>58</sup> and South Asia (with India and Pakistan) (see Figure 2), we can discern a greater Asian economic community in the making. Gigantic China has clearly played a pivotal role in the formation of the Asian economic community.

Strategically, China entered into RTAs first with Hong Kong and Macau. Compared with ACFTA, CEPA has been implemented at a pace much faster than any other RTAs involving China and other regions, including ASEAN countries. This indicates that CEPA is a more comprehensive, profound and specific opening approach. Regarding energy security, China has also listed several countries in its FTA timetable: for example, China–GCC FTA negotiations are underway.<sup>59</sup> Since its accession to the WTO, China has established a clear target model for participating in RTAs, beginning with neighbouring countries, gradually expanding to emerging markets and developed countries and then further radiating into important energy bases (see Figure 3). China's FTA partners now include the ASEAN countries in Asia, Chile in South America, Iceland in North Europe and the Southern African Customs Union<sup>60</sup> in Africa, as well as developing countries such as Pakistan and developed countries like Australia and New Zealand, with which China is conducting negotiations.

### 4.3 Future Prospects

In October 2007, the Report to the 17th CPC National Congress laid down the guidelines of “implementing the free trade area strategy and strengthening bilateral and multilateral economic and trade cooperation” for the first time ever.<sup>61</sup> This is an inevitable choice for China in

<sup>58</sup> The Shanghai Cooperation Organization (SCO) is an intergovernmental mutual-security organization founded in 2001 by the leaders of China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan. Except for Uzbekistan, the other countries had been members of the Shanghai Five, founded in 1996; after the inclusion of Uzbekistan in 2001, the members renamed the organization. All SCO members but China are also members of the Eurasian Economic Community. A Framework Agreement to enhance economic cooperation was signed by the SCO member states on 23 September 2003. At the same meeting Chinese Premier, Wen Jiabao, proposed a long-term objective to establish a free trade area in the SCO, while other more immediate measures would be taken to improve the flow of goods in the region.

<sup>59</sup> The Gulf Cooperation Council (GCC) was established in an agreement concluded on 25 May 1981 in Riyadh, Saudi Arabia, between Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. These countries declared that the GCC has been established in view of the special relations between them, their similar political systems based on Islamic beliefs, joint destiny and common objectives. The GCC is a regional common market with a defence planning council as well. The geographic proximity of these countries and their general adoption of free trade economic policies are factors that encouraged them to establish the GCC.

<sup>60</sup> Southern African Customs Union comprises 5 countries: Botswana, Namibia, South Africa, Lesotho and Swaziland.

<sup>61</sup> Hold High the Great Banner Of Socialism with Chinese Characteristics and Strive For New Victories in Building A Moderately Prosperous Society In All Respects, Report to the 17th National Congress of the CPC, October 15 2007, available at:

its pursuit of economic globalization and regional economic integration, defining a moment in history and seizing the opportunity.

The global financial crisis poses enormous difficulties and challenges to the world economy. Implementing the free trade area strategy at a faster pace is of vital importance for China, if it is to withstand the financial crisis and maintain stable import and export growth.

In the regional economic cooperation process, proactive integration is far more advantageous to China than passive integration. A certain amount of compromise on economic sovereignty is a wise choice, due to the enormous economic benefits to be gained. Outside of RTAs, China would be unable to obtain the benefits of regional economic integration and would be likely to suffer exclusion or repulsion to varying extents.<sup>62</sup> China intends to participate proactively in regional economic cooperation, with ties of closer economic and trade relationships aimed at promoting mutual benefit and joint development. This not only dovetails with China's political, diplomatic and security interests but also helps to create a sound international environment for the country's modernization drive.

It is therefore imperative for China to participate in or advocate establishing RTAs regardless of safeguarding its own interests or conforming to the world's economic development trend. For China, RTA are an important means of promoting growth in foreign trade, introducing advanced technology and management expertise, leveraging comparative advantages and accelerating economic development in the long run.<sup>63</sup>

#### 4.4 Textual Content of China's RTA Participation

The product coverage and scope of China's FTA agreements with its partners have been relatively comprehensive, not only covering tariff

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[news.xinhuanet.com/newscenter/2007-10/24/content\\_6938568.htm](http://news.xinhuanet.com/newscenter/2007-10/24/content_6938568.htm) (accessed on 19 February 2009).

<sup>62</sup> Charles Bram Cadsby, Kenneth Woodside, "The Effects of the North American Free Trade Agreement on the Canada-United States Trade Relationship", *Canadian Public Policy* (Vol. 19, No. 4, Dec. 1993), p. 450. The author concludes that the NAFTA has involved both positive and negative changes for Canada's trading relationship with the United States. However, the gains slightly outweigh the losses. Participating in the NAFTA, while only a slight improvement over the status quo, is a better alternative for Canada than staying outside a bilateral arrangement between the United States and Mexico.

<sup>63</sup> Daniel Trefler, "The Long and Short of the Canada-U.S. Free Trade Agreement", *The American Economic Review* (Vol. 94, No. 4, Sep. 2004), p.870. The Canada-US Free Trade Agreement provides a unique window onto the effects of a reciprocal trade agreement on an industrialized economy (Canada). For industries that experienced the deepest Canadian tariff cuts, the contraction of low-productivity plants reduced employment by 12% while raising industry-level labour productivity by 15%. For industries that experienced the largest US tariff cuts, plant-level labour productivity soared by 14%. These results highlight the conflict between those who bore the short-run adjustment costs (displaced workers and struggling plants) and those who are garnering the long-run gains (consumers and efficient plants).

cuts in trade in goods, but also touching upon market access related to trade in services and some other issues. Otherwise, however, the textual content of China's FTAs varies, so a brief description of a few typical FTA agreements is in place here.

#### **4.4.1 CEPA and its Supplementary Agreements<sup>64</sup>**

CEPA is the most sophisticated FTA negotiated by mainland China so far. It covers trade in goods, trade in services, investment, and intellectual property. Under CEPA, Mainland China has applied zero tariffs to all imported products produced in Hong Kong and Macao since 2006 and provided better treatment in 29 service sub-sectors. Forty-four cities on the mainland have started individual tourist businesses for travel to Hong Kong and Macao. Over 1400 individuals' professional qualifications in the areas of construction, accounting and medical services have been mutually recognized between the Mainland and Hong Kong. Regarding the liberalization of legal services, the Mainland permits HK Chinese to participate in national legal profession examination, apply for legal practising certificates and engage in Mainland non-litigation legal affairs. In addition, HK law firms are allowed to establish contractual joint ventures with Mainland law firms, and Mainland law firms may employ HK lawyers.

#### **4.4.2 China-ASEAN FTA<sup>65</sup>**

The ASEAN-China Free Trade Area (ACFTA) covers investment and economic cooperation, as well as trade in commodities and services. Priority areas include agribusiness, information technology, human resources development, investment promotion and the development of the Mekong area. The plan is to reduce tariffs on more than 7000 items of both sides, since 2005, and to form FTAs with six early ASEAN members (Brunei Darussalam, Cambodia, Indonesia, Malaysia, Singapore and Thailand) and later members, in 2010 and 2015, respectively. The China-ASEAN Early Harvest Programme was launched on 1 January 2004, to gradually reduce tariffs on 500 commodities (mostly agriculture products) to 0 by 2006. In November 2004, the two parties entered into a Commodity Trade Agreement aimed at reducing tariffs on ordinary commodities to 0-5% between 1 July 2005 and 2010. Tariffs on 400 sensitive items will also be reduced to 5% and less from 2012 to 2018. At that point, ASEAN will also apply a zero tariff on over 90% of Chinese products from China.

<sup>64</sup> Text available at :< [fta.mofcom.gov.cn/cepa/cepa\\_jianjie.shtml](http://fta.mofcom.gov.cn/cepa/cepa_jianjie.shtml)>.

<sup>65</sup> Text of China-ASEAN FTA available at :  
< [fta.mofcom.gov.cn/dongmeng/dm\\_xieyijianjie.shtml](http://fta.mofcom.gov.cn/dongmeng/dm_xieyijianjie.shtml)>.

#### 4.4.3 China–Chile FTA<sup>66</sup>

The China–Chile FTA is the first such agreement that China has signed with any Latin American country. President Hu Jintao and President Ricardo Lagos announced the beginning of China–Chile FTA negotiations on 18 November 2004. There followed five rounds of discussions on such issues as market access, rules of origin, technical barriers to trade, sanitary and phytosanitary measures, trade remedies, dispute settlement and cooperation. The two countries agreed to launch tariff reductions on 1 July 2006. Tariffs on products constituting 97% of the total custom codes will be removed over a ten-year period. The two countries intend further collaboration in the following areas: economy, small and medium-size enterprises, culture, education, science and technology, environment, labour and social security, intellectual property, investment, mineral products and industry. The China–Chile FTA has created a mutually beneficial situation: China has become Chile's largest trade partner in copper and copper ores, and Chile has better access to high-quality and low-priced Chinese products, such as electrical home appliances and textiles. In 2007, bilateral trade increased by 65%. Thereby, China surpassed the USA to become the major export destination of Chilean products. China's 23 service sub-sectors will further open to Chilean providers.

#### 4.4.4 China–New Zealand FTA<sup>67</sup>

The China–New Zealand FTA is the first FTA negotiated between China and a developed country. In November 2004, Chinese President Hu Jintao called for an early start to China–New Zealand FTA negotiations. The following topics have been covered: trade in goods, trade in services, non-tariff measures, investment, rule of origin, sanitary and phytosanitary measures, and safeguards. China has agreed to eliminate tariffs on most products imported from New Zealand by 2019, whereas New Zealand has agreed to its tariffs on all products from China by 2016. China will provide more preferential treatment in 15 sub-sectors, as will New Zealand in 16 sub-sectors. Additionally, the agreement includes cooperation in temporary entry by natural persons, customs, investment promotion and protection, IP protection and dispute settlement.

#### 4.4.5 China–Pakistan FTA<sup>68</sup>

China and Pakistan signed a preferential trade agreement on 3 November 2003. China would give Pakistan an average of 18.5% tariff reduction on 893 items, while Pakistan would reciprocate by offering

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<sup>66</sup> Text available at :< [fta.mofcom.gov.cn/chile/chile\\_xieyibeijing.shtml](http://fta.mofcom.gov.cn/chile/chile_xieyibeijing.shtml)>.

<sup>67</sup> Text available at :< [fta.mofcom.gov.cn/newzealand/newzealand\\_xieyi.shtml](http://fta.mofcom.gov.cn/newzealand/newzealand_xieyi.shtml)>.

<sup>68</sup> Text available at :< [fta.mofcom.gov.cn/pakistan/pakistan\\_xieding.shtml](http://fta.mofcom.gov.cn/pakistan/pakistan_xieding.shtml)>.

China the same treatment as provided to India under the Bangkok Agreement, which concerns a 27.7% reduction in tariffs. In December 2004, the two parties jointly launched a feasibility study on a China–Pakistan FTA, and negotiations got underway in April 2005. The two governments signed an Early Harvest Agreement on mutual reduction of tariffs within two years from 1 January 2006. China will reduce tariffs on 52 items and Pakistan will reduce tariffs on 51 items under 4-digit category. Further, the two parties entered into quarantine protocol on rice, oranges and live goats, and agreed on cooperation in high-tech, energy, and infrastructure development. In the Agreement on Trade in Services, “services” is defined as any service in any sector except services supplied in the exercise of governmental authority. However, the Agreement does not apply to services supplied in the exercise of governmental authority within the territory of each party, subsidies or grants provided by a party, air transport services and cabotage in maritime transport services.

#### **4.5 Motivation for China’s RTA Participation**

Compared with the MTS, the RTA has at least three advantages:<sup>69</sup> i ) participants are mostly adjacent countries, and transportation costs (freight) are lower for economic and trade exchange between them; ii ) few member states are involved, so domestic policy can be coordinated easily and the costs of negotiation are low; iii ) the benefits of integration are clear and direct, and the interest-compensation mechanism can be easily established. By participating in RTAs, China can obtain the same benefits of market openness and trade and investment liberalization as other countries do. In addition, China has special economic and political interests at stake.

##### **4.5.1 A strategic choice in the prevailing global financial crisis**

Compared with the 1998 Asia financial crisis, China is now in a much better position to mobilize domestic and international markets and resources in responding to the current international financial crisis. FTAs play an important role in maintaining China’s stable import and export growth.

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<sup>69</sup> Raquel Fernandez, Jonathan Portes, “Returns to regionalism: An analysis of non-traditional gains from regional trade agreements”, *World Bank Economic Review* (Vol. 12, No. 2, May 1998), p197. According to this article, RTAs can serve a useful economic purpose beyond the direct gains from trade liberalization, by reducing uncertainties and enhancing credibility. Such credibility would apply to a stable legal environment in Poland, continued access to US markets for Mexican products, or a local market of sufficient size for a new plant in Uruguay. Increased credibility makes it easier for the private sector to plan and invest. Indeed, in some cases the reduction in uncertainty resulting from an RTA may even be a necessary precondition to realizing gains from liberalization.

First and foremost, FTAs can promote the diversification of China's export markets. The Gulf Cooperation Council (GCC), Australia, Korea and other countries conducting FTA negotiation or feasibility studies with China represent important export markets with great potential for China. Developing these markets by way of FTAs can help China to diversify the external contraction risks associated with to the current financial crisis.

Secondly, FTAs can reduce Sino-foreign trade friction, by helping to reduce and alleviate trade disputes, acting as a buffer zone. In its FTA agreements, China practises mutual recognition of standards with respect to technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS) with other countries, to facilitate trade cooperation.

Moreover, FTAs can assist in further establishing the image of China as an open and responsible powerhouse: an important way by which China can work to build a "harmonious world". FTAs can help to repudiate attempts to blame or slander China as "the root cause of the global financial crisis".<sup>70</sup>

#### **4.5.2 A *sine qua non* trade liberalization in the Asia-Pacific region**

RTAs have been mainly concentrated in the Euro-American region, with a slower start in the Asia-Pacific region. Although the formation and development of APEC<sup>71</sup> has helped in promoting regional cooperation in the Asia-Pacific region, significant disputes remain among its members with regard to its organizational nature and principle, thereby reducing the organization to a consultative forum on economic cooperation.

Against this background, establishing regional trade cooperation in the form of ACFTA has become a necessary requirement for the Asia-Pacific region to join the wave of regional trade liberalization worldwide. For China, developing regional trade cooperation with neighbouring countries, as through ASEAN, helps to strengthen ties

<sup>70</sup> See, for example, Krishna Guha, *Paulson says crisis sown by imbalance*, published 2 January 2009, available at: <[www.ft.com/home/asia](http://www.ft.com/home/asia)> (accessed on 19 February 2009); and Martin Wolf, *Asia's revenge*, published 8 October 2008, available at: <[www.ft.com/comment/analysis](http://www.ft.com/comment/analysis)> (accessed on 19 February 2009).

<sup>71</sup> APEC was established in 1989 to further enhance economic growth and prosperity in the region and to strengthen the Asia-Pacific community. APEC is the only inter-governmental grouping in the world operating on the basis of non-binding commitments, open dialogue and equal respect for the views of all participants. Unlike the WTO or other multilateral trade bodies, APEC has no treaty obligations required of its participants. Decisions made within APEC are reached by consensus and commitments are undertaken on a voluntary basis. APEC has 21 member states, accounting for more than a third of the world's population (2.6 billion people), approximately 60% of world GDP (US\$19,254 billion) and about 47% of world trade. It also proudly represents the most economically dynamic region in the world, having generated nearly 70% of global economic growth.



with these countries, stabilize the contiguous environment and safeguard national security.

Establishing the ASEAN-China Free Trade Area (ACFTA) represents a new path for ASEAN countries to seek further development opportunities. ACFTA can strengthen the reciprocal and mutually advantageous relations between ASEAN and China. The participation of such a powerhouse as China in Asia-Pacific regional economic integration also helps to maintain the economic and monetary stability of the entire region. Each step of progress in ACFTA means that Asia will garner more tangible benefits from China's rapid economic growth.

#### **4.5.3 Adjusting relations with other nations**

In the 21st century, inter-state relations have begun to focus on building strategic trust and avoiding confrontation. By participating in RTAs, China can participate in international affairs with one voice and one stance for the common interests of all parties involved, with a view to strengthening their negotiating position and comprehensive strength, and promoting regional security and world polarization.

A stable development environment affords basic assurance for the Chinese economy to grow on a sustainable basis. Under the "Early Harvest Programme"<sup>72</sup> of ACFTA, China has significantly alleviated concerns over "China threats". As China actively accorded ASEAN countries mutually beneficial treatment, the 10 ASEAN countries decided on 29 November 2004 to recognize China's status as a full market economy. In addition, establishing FTAs with resource-intensive regions such as the Gulf Cooperation Council (GCC) opens up a stable supply channel for China to import strategic energy resources.

#### **4.5.4 Achieving optimal allocation of production factors**

One of the key objectives of regional trade cooperation is to promote the movement and optimum allocation of production factors between regions, enabling all member states participating in the RTA to benefit from the international division of labour and trade within a broader scope.<sup>73</sup> Therefore, the process of regional trade liberalization is inevitably intertwined with the further development of specialized produc-

<sup>72</sup> This programme is an integral part of FTA, covering the lists for zero-tariff products and preferential tariff products. It is intended to facilitate enterprises of both sides to benefit from the FTA and boost the confidence of both governments in FTA negotiations.

<sup>73</sup> Michael R. Smith, "A Sociological Appraisal of the Free Trade Agreement", *Canadian Public Policy* (Vol. 15, No. 1, Mar. 1989), p57. Smith suggests two different sets of grounds on which sociologists might appraise the FTA. First, there are its likely effects on inequality, which is one of the major preoccupations of the discipline. Second there is the question of its effects on the feasibility of alternative future policy options.

tion and economy of scale, along with the accelerated movement of production factors and regional comparative advantages.

We may take the China and Asia–Europe Meeting (ASEM)<sup>74</sup> as an example. In 2007, the trade between China and ASEM member states totalled US\$ 1 trillion, accounting for approximately one half of China's foreign trade.<sup>75</sup> The EU, Japan, ASEAN, South Korea and India were the first, third, fourth, sixth and tenth largest trade partners of China in 2007. Greater integration and reducing or removing trade barriers within each region will be more favourable to China's foreign trade flow.

China has become recognized as the economy with the greatest economic development potential in the 21st century. In the midst of rapid market change, however, the lack of economies of scale has weakened the competitiveness of Chinese enterprise and caused production costs to rise. By RTA participation, China can work together with other members within each region to effectively realize economies of scale. This means that Chinese enterprises will be able to leverage their advantages and reduce their costs through economies of scale, to meet the growing market demand at home and abroad.

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<sup>74</sup> ASEM was established in 1996. The current coordinators are China, Brunei, European Commission and France. For the past 12 years, ASEM has been the main multilateral channel for communication between Asia and Europe, strengthening interaction and mutual understanding between the two regions through dialogue.

<sup>75</sup> Available at :< [www.news365.com.cn/gdxww/1395624.htm](http://www.news365.com.cn/gdxww/1395624.htm)> (accessed on 19 February 2009).

## 5. China's RTA Participation: Strategic Objective and Policy Option

### 5.1 Advantages

The economic and structural reforms in China in the last 20 years have compressed a process which in “developed” countries commenced with the Industrial Revolution of the 18th century. Whilst not perfect in an historical context, the end result in the PRC has been quite remarkable. China has already demonstrated its capacity and commitment to economic reform, as well as the willingness to take some risks by moving quickly, as was clearly evident in the 1990s.

On 10 November 2001, China joined the WTO by signing the Accession Protocol. Since then, China has effected significant economic and structural reform of its economy and legal systems to satisfy the requirements of the WTO. It has subsequently continued to pursue its course away from a centrally planned economy, through its status under the WTO as an “economy in transition” towards a full market economy. This in itself should warrant some accommodation in expectations towards China. Moreover, it represents a unique opportunity within Asia-Pacific region to share in the benefits of the growth and opening of China.

In terms of regionalism, the Asia-Pacific region including East Asia is the world's least developed region. Recently, the countries of East Asia have begun to consider a new vision regional economic cooperation. Especially after the financial crisis in 1997, the Northeast Asian countries (China, Japan, and Korea) began to show a great interest in establishing RTAs.

Now the world is waiting to see which country will take the lead in East Asian regionalism. China is widely anticipated to become more actively involved, for several reasons. First, China has almost completed implementing the tariff reductions and economic reforms stipulated in the WTO Accession Protocol, and will be ready to face FTA issues more progressively. Second, China will be more responsive to economic integration in other regions such as the expansion of EU and the formation of NAFTA. Third, when DDA negotiations have reached a critical stage of suspension, major trading countries have increasingly paid attention to bilateral approaches like those under an FTA, further boosting the current interest in regionalism.

## 5.2 Strategic Objectives

RTAs represent an important entry point for China to open further to the outside world, as well as being a strategic option for China to adapt to the increasing economic globalization trend. However, so far, very few materials have been made available on China's foreign trade policy, especially regarding its policy on RTAs. When China began to negotiate RTAs with other economies, there were already more than 200 RTAs globally, so it needed to catch up with the rest of the world quickly.

China is still on the learning curve of RTA arrangements. The prospects of China's RTA participation are likely to be affected by the country's internal problems, such as an insolvent financial sector, remnants of a socialistic economic system, and regional income gaps between urban and rural areas.

According to the general theories of RTA, when a developing country establishes an RTA with a developed economy, resources will be optimized and the industrial structure of the developing country will be upgraded due to trade transfer. Based on its experience with ASEAN and CEPA, China has experienced some progress in the investment and trade areas, but the impact on the country's overall economy is very limited, and further efforts need to be made in trade and investment facilitation.

FTA partner composition and regional priority is the basis of a country's RTA strategy. It is important for China not to act too hastily, but to push forward regional cooperation step by step from adjacent to remote regions and level by level, from easy to difficult regions. In the meantime, China needs to establish closer economic and trade relations with other countries and regions on a reciprocal and mutually advantageous basis.

The overall strategic objective for China's RTA participation is to: *build a free trade rim encompassing most adjacent countries and regions and a global free trade area network covering the major countries across the five continents within the period 2009 to 2020, according to the requirements of the 17th CPC National Congress for "implementing the free trade area strategy and strengthening bilateral and multilateral economic and trade cooperation" to liberalize and facilitate more than 50% of China's bilateral trade and two-way investment.* By doing so, China can expand its economies of scale, boost economic competitiveness, ensure resource supply and push for the establishment of a favourable geo-economic and geo-politic pattern and a new global economic and politic order – eventually making it possible to realize peaceful development.

Based on this objective, the overall strategic motivation for China is to: *domestically, speed up the process of cooperation between Hong Kong, Macau, Taiwan and Mainland China and establish a “Greater China Free Trade Area”;*<sup>76</sup> *in Asia; seek regional or sub-regional cooperation with neighbouring countries; internationally, build a global free trade area network across borders and continents to incorporate the vast majority of emerging economies, major developing countries or bridgehead countries, resource-abundant countries and a number of developed countries.* Building the “Pan-China Economic Area”<sup>77</sup> and seeking equal dialogue with the EU and North America while promoting economic development and prosperity in the Asia-Pacific region is a necessary correlate of this process.

### 5.3 Policy Options

China’s economic development needs a stable and peaceful environment. RTAs can enhance trade and investment volumes in the region, as well as facilitate trade in goods and trade in services among their members. The dynamic global development of RTAs, coupled with China’s economic boom, has provided sound foundation for China to seek regional economic and trade cooperation. It is highly possible that China will become more progressive in considering bilateral and sub-regional RTAs in the near future. Asia is especially important to China, and Asian economic cooperation is the foundation of China’s RTA policy.

#### 5.3.1 An active participant in promoting Asian economic integration

The significant discrepancies still remaining among Asian countries make it difficult to form a unified regional cooperation organization in Asia in the near future. At present, a realistic option is for some Asian countries endowed with more favourable geographic, cultural and economic conditions to take the lead in forming a regional or sub-regional cooperation organization. As the largest developing country in Asia, China should focus on Asia and seek regional or sub-regional economic cooperation with its neighbours, with a view to proactively participating in and pushing forward the process of Asian regional economic integration.

<sup>76</sup> The Greater China Free Trade Area is defined as the economic integration of Hong Kong, Macao, the Chinese Mainland, and Taiwan.

<sup>77</sup> The “Pan-China Economic Area” is defined as a complementary win-win cooperative community consisting of i) the “Greater China Free Trade Area” comprising Hong Kong, Macau, Taiwan and Mainland China and ii) the ASEAN countries.

**First and foremost, China should take the establishment of the “Greater China Free Trade Area” as the most preferred option and topmost priority for implementing its RTA strategy.** As a political and economic powerhouse, China needs to establish a self-focused RTA irrespective of the vantage points of global strategy or regional strategy. Hong Kong, Macau and Taiwan are three separate customs territories in China and serve as reciprocal trade and investment partners of one another. Hong Kong, Macau, Taiwan and Mainland China should establish a Greater China FTA, to promote greater economic prosperity and development for themselves. That would also be an initiative that conforms to the historical trend, the prerequisite for the unification and rejuvenation of China and the new development of “one country, two systems”.

**Secondly, China should further strengthen its regional economic cooperation with ASEAN countries and build up ACFTA in 2010 as per the set objective.** Establishing ACFTA will not only reinforce and strengthen friendly cooperative relations between China and ASEAN: it will also promote the economic development of China and ASEAN, expand the scale of bilateral trade and cooperation and boost the overall competitiveness of the entire region.

**Thirdly, China should proactively push forward the “10+3” process of regional economic cooperation.**<sup>78</sup> The countries of East Asia are China’s close neighbours. In the long run, East Asia has the basis and development prospects for trade liberalization. “10+3” emphasizes pushing forward dialogue and cooperation among East Asian countries, so as to promote mutual understanding, reciprocal trust and good-neighbourly relations and undertaking to pursue cooperation in many areas, including economy, trade, finance and technology.

**Fourthly, China should initiate China–ROK FTA negotiations as soon as practical.** As Asia’s third largest economy that fosters sound political, economic and trade relations with China, the Republic of Korea (ROK) is an important partner for China to establish a free trade area. The China–ROK FTA is currently at the research stage. China should initiate China–ROK FTA negotiations as soon as possible, aiming to complete negotiations by 2009 and build up the China–Japan–Korea FTA by 2020.

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<sup>78</sup> In 1997, a summit meeting between the ASEAN countries and China, Japan and South Korea (ASEAN+3) was convened. Thereafter an annual summit has been held involving all thirteen (10+3) East Asian nations. The emergence of ASEAN+3 closely reflects the rise of East Asian regionalism and identity.

### **5.3.2 Economic integration in the Asia-Pacific region as well as other sub-regional economic cooperation**

In selecting partners for regional economic cooperation, China shall give priority to developed countries that possess capital, technology, management and talent advantages and occupy a leadership position in the world economy. The United States, the EU and Japan are China's most important economic and trade partners, today and in the foreseeable future. Maintaining good cooperative relations cooperative relations with these superpowers is of crucial importance for China.

**Firstly, China should further participate in APEC activities and seek to speak out in the rule-setting process, in order to safeguard its economic interests and economic security.** As a cooperation mechanism with the most extensive influence in the Asia-Pacific region, APEC plays an active “push” role in liberalizing and facilitating Asian trade and investment.<sup>79</sup> By proactively participating in APEC activities, China can strengthen its opening-up drive and accumulate experience for further participation in regional integration.

**Secondly, China should proactively advocate establishing a new regional cooperation model of the SCO to maintain regional stability and develop friendly cooperation.** The Shanghai Cooperation Organization (SCO) reflects an update in China's philosophy of regional cooperation. In the future, China intends to continue to intensify mutually advantageous cooperation in respect of politics, security, diplomacy, economy, trade and culture under the SCO framework; initiate the trade and investment facilitation process; and conduct economic and technological cooperation with Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan, as well as creating favourable conditions for trade liberalization in this region.

**Thirdly, China should advance sub-regional economic cooperation on a selective basis, while proactively participating in RTAs.** With its vast territorial expanses of land and sea, China shares border with numerous other countries. While pursuing bilateral and multilateral cooperation, China will need to push forward sub-regional economic cooperation in the areas along its borders: for example, the Yellow Sea and Bohai Sea Economic Rim, the Northeast Asian Economic Rim, Japan Sea Economic Rim and North China Economic Rim.

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<sup>79</sup> Melaku Geboye Desta, “The Organization of Petroleum Exporting Countries, the World Trade Organization, and regional trade agreements”, *Journal of World Trade* (Vol. 37, No. 3, Jun. 2003), p 523. This article sheds some light on the issue of whether the MTS has any room to accommodate OPEC as an organization, and analyses the interface between these two organizations in the existing international economic order and their respective roles over the petroleum industry. In an effort to overcome the problem, leading GATT/WTO Members opted for the non-multilateral path, and particularly the path of regional trading arrangements.

### **5.3.3 Reform and opening up to improve international competitiveness and overall national strength**

Economic strength and product competitiveness are central important factors in RTAs. China will need to deepen the reform of its market economic system, effectuate the fundamental transformation from planned economy to market economy and transform its economic growth from the “brute force” mode into the “lean and smart” mode.

**Firstly, China needs to deal with the relationship between opening its domestic market and developing its domestic industry.** China should formulate its guideline and policy for foreign negotiation under the “give and take” and “win-win” principle. Care is especially important in handling the relationship between economic benefits and politic, cultural and military benefits, the trade-off between short-term gains or losses and long-term benefits and the pros-and-cons relationship between different sectors.

**Secondly, China should expand the breadth, width and depth of its international exchange and cooperation and create a sound political, military and cultural environment.** Economic and trade exchange and cooperation cannot exist on a standalone basis: they rely on building mutual trust on the political dimension, eliminating hostility on the military front and enhancing reciprocal integration in the cultural sphere. China needs to strive to strengthen its political, military and cultural exchange and cooperation, while continuing its proactive RTA participation.

**Thirdly, China should mobilize and leverage the enthusiasm of business executives and entrepreneurs for participating in RTA negotiations.** It is important for the Chinese government to listen to the comments and requests of business executives and entrepreneurs and give them warm encouragement and guidance. In some key cooperation projects, the government needs to make meticulous preparations for organization and coordination work, to enable state-owned enterprises and private enterprises to find their roles amid international competition and cooperation.

### **5.3.4 Opening to the outside world and furthering the development of the MTS**

RTAs and the MTS are the two major ways by which China participates in economic globalization. Each of them has its strengths and weaknesses and both combine to form “complementary competition”. One effective means to offset and reduce the negative effects of regional economic cooperation is to proactively push forward and participate in the global multilateral trading system. This means reinforc-



ing the foundation of WTO multilateral trade rules, curbing trade protectionism and dealing fairly with the relations among RTA member states in accordance with authoritative, universal and binding multilateral rules.

**Firstly, China should properly coordinate its RTA/MTS participation.** China should “walk on two legs”. On the one hand, China needs to be active in the Doha Round and strive to establish a fair and free global trading system characterized by the reciprocal opening of markets and an adequate flow of resources; on the other hand, by participating in RTAs, China should gain the benefits of regional market opening and trade/investment liberalization, while stabilizing its neighbouring environment and ensuring external resource supply.

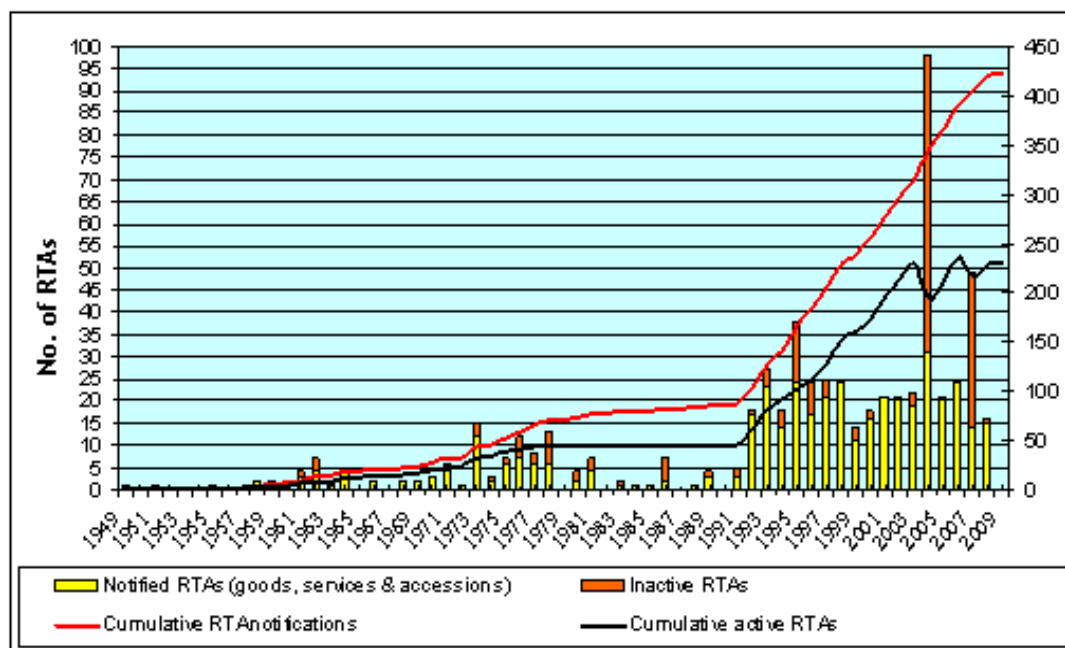
**Secondly, China should play a constructive role in the MTS.** As the largest developing-country member of the WTO, China should, in each round of negotiations, seek fair, equitable and reasonable treatment for the developing countries. At the same time, China must clearly understand where its interests lie, and determine its negotiation stance and strategy on the basis of its own interests. The diversification of Chinese interests dictates that China cannot determine its negotiation attitude and strategy on the basis of “camps” or “groups”; that would be putting its own interests under extreme constraints and even in jeopardy.

**Thirdly, China should proactively and reasonably dissolve foreign trade disputes under the framework of WTO rules.** The rule-based MTS requires members to properly resolve trade friction and dispute in accordance with WTO rules, instead of resorting to trade wars or unilateral action. In the next 20 years, during its transition from a big trade house to a strong trade house, China is likely to face an increasing number of foreign trade disputes. The Chinese government and business will need to treat such trade disputes dialectically and rationally, utilizing the WTO dispute resolution mechanism. In addition, China should make flexible use of the WTO “safety valve” mechanism.<sup>80</sup> In opening further to the outside world, China should safeguard its own economic and trade rights and interests in a manner consistent with scientific principles and international norms, thereby weakening any negative effects of market opening on its domestic economy.

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<sup>80</sup> The “safety valve” refers to those permissible import restraints that otherwise would be contrary to WTO principles, essentially, exceptions to the bedrock rules of binding tariffs and MFN. It is designed to allow relief from imports deemed “unfair,” or adjustment from a surge in imports. WTO identifies three primary types to allow further trade liberalization: safeguards (temporary relief from import surges), countervailing duties (counteracting subsidies), antidumping (counteracting unfairly low prices).

## Appendix: Figures and Tables



**Figure 1 : Evolution of RTAs in the world (1948-2009)**

Source: WTO Secretariat.

**Table 1: RTAs notified to the GATT/WTO and in force by type**

	Enabling clause	GATS Art. V	GATT Art. XXIV	Total
Customs Union	6		7	13
Customs Union - Accession	0		6	6
Economic Integration Agreement		61		61
Economic Integration Agreement - Accession		6		6
Free Trade Agreement	9		137	146
Free Trade Agreement - Accession	0		2	2
Preferential Trade Agreement	12			12
Preferential Trade Agreement - Accession	1			1
<b>Total</b>	<b>28</b>	<b>67</b>	<b>152</b>	<b>247</b>

Source: WTO Secretariat.

**Table 2: Categories of China's Participation in Regional Cooperation**

<b>Categories</b>	<b>Characteristics</b>	<b>Representative Form</b>
Regional cooperation under a specific mechanism	Loose and extensive	“10+3”, Shanghai Cooperation Organization, Tumen River Sub-regional Cooperation, Mekong River Sub-regional Cooperation
Regional cooperation of forum nature	Loose and open	APEC, ASEM, South Summit BOAO Forum for Asia
Regional cooperation under substantially preferential trade arrangement	Realistic and extensible	CEPA, ACFTA, China–Chile FTA, China–Brazil FTA, China–Singapore FTA, Asia Pacific Trade Agreement

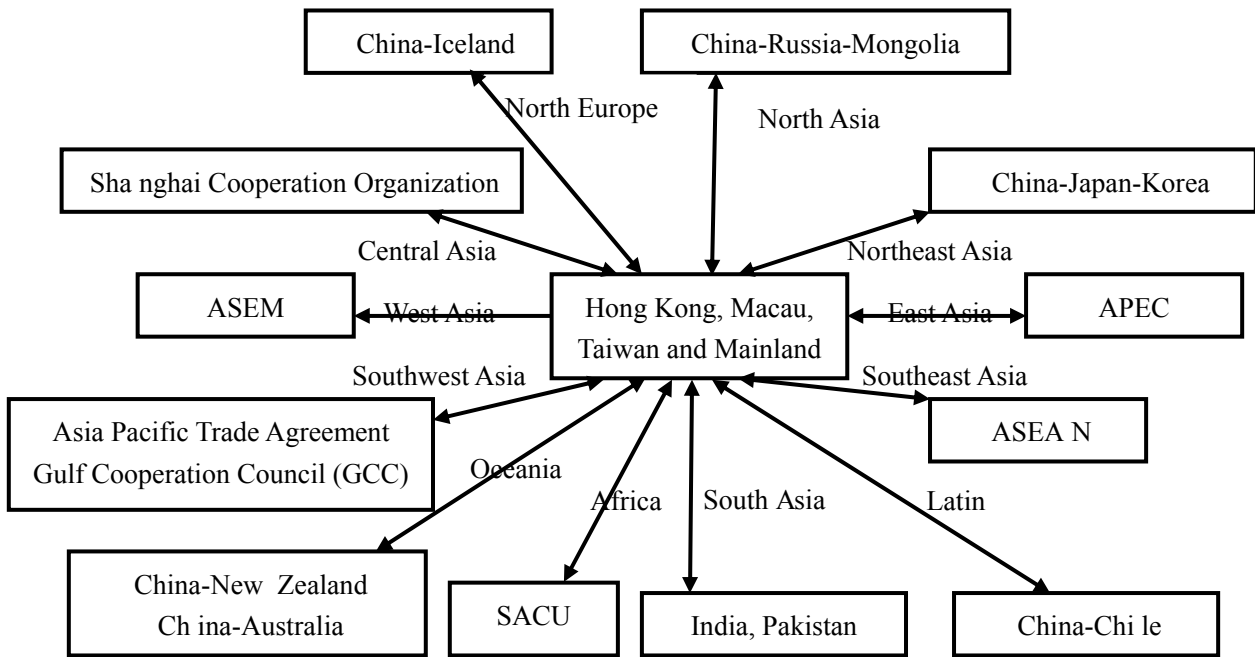
**Table 3: China's RTA Participation**  
(As of December 2008)

FTA	Country/Region	Remarks
<b>Signed Agreements</b>	Mainland–Hong Kong	CEPA took effect in January 2004; 5 supplementary agreements signed.
	Mainland–Macau	CEPA took effect in January 2004; 5 supplementary agreements signed.
	China–ASEAN	The Agreement on Trade in Goods was signed in November 2004 and took effect in July 2005. The Agreement on Trade in Services was signed in January 2007. The Investment Agreement was signed in August 2008.
	China–Chile	The agreement was signed in November 2005 and took effect in October 2006. The Agreement on Trade in Services was signed in April 2008.
	China–New Zealand	The agreement was signed in April 2008 and took effect on 1 October 2008.
	China–Pakistan	The agreement was signed in November 2006 and took effect on 1 July 2007. The Agreement on Trade in Services was signed in October 2008.
	China–Peru	Negotiations started in September 2007; the agreement was signed in November 2008.
	China–Singapore	Negotiations started in August 2006 and the agreement was signed in September 2008.
	Asia Pacific Trade Agreement	From 1 September 2006, China offered other member states preferential tariffs. Correspondingly, China was entitled to preferential tariffs from India, Korea, Sri Lanka and Bangladesh.
<b>Under negotiation</b>	China–Australia	Negotiations started in May 2005; 13 rounds of negotiations have been held.
	China–GCC	Negotiations started in July 2005; 4 rounds of negotiations have been held.
	China–Costa Rica	Study started in January 2008; negotiations started in January 2009.
	China–Iceland	Negotiations started in April 2007; 4 rounds of negotiations have been held.
	China–SACU	Negotiations started in June 2004.
	China–Norway	Negotiation started in September 2008; 2 rounds of negotiations have been held.
<b>Under study</b>	China–India	Study started in April 2005, joint study was completed in October 2007.
	China–ROK	Study started in November 2006; 5 workgroup meetings have been held.

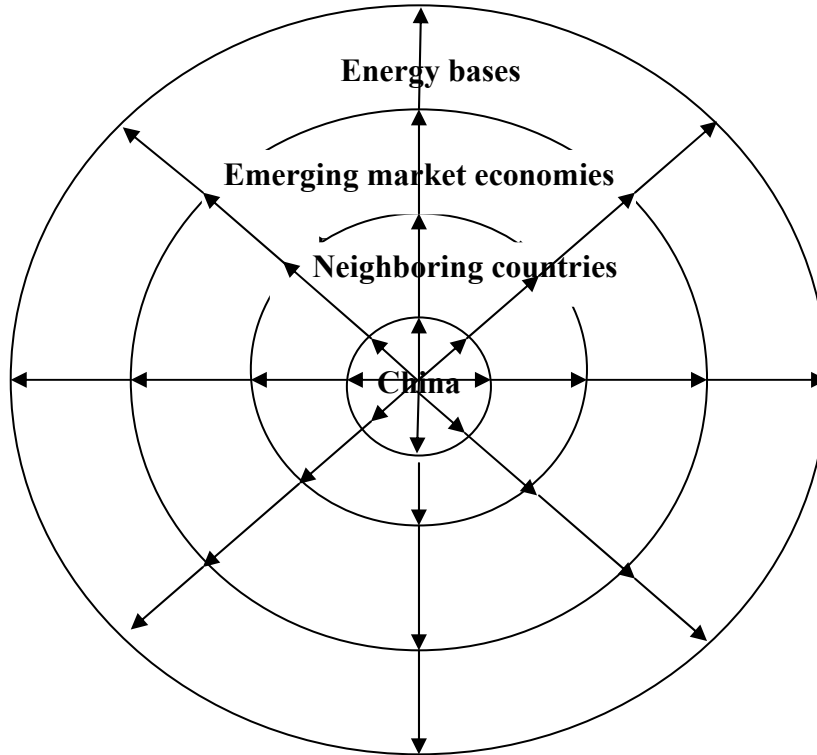
**Table 4: Bilateral Trade between China and FTA Partners in 2007**  
(Unit: US\$ 100 million)

<b>Country/Region</b>	<b>Total (YoY)</b>	<b>Import (YoY)</b>	<b>Export (YoY)</b>
<b>Hong Kong</b>	1972(22%)	128(18.9%)	1844(18.8%)
<b>ASEAN</b>	2025(25.9%)	1084(21%)	941(32%)
<b>Gulf Cooperation Council</b>	580 (29%)	303 (14%)	277 (51%)
<b>Singapore</b>	472 (15.4%)	175 (-0.9%)	296 (27.8%)
<b>Australia</b>	438(33%)	259(34%)	180(32%)
<b>Southern African Customs Union</b>	147(60%)	68(84%)	79 (44%)
<b>Chile</b>	88 (24%)	57 (15%)	31 (44.6%)
<b>Pakistan</b>	69 (31%)	11 (9.7%)	58 (36.4%)
<b>Peru</b>	60 (54%)	43 (49%)	17 (66%)
<b>New Zealand</b>	37(26%)	15(17%)	22(33%)
<b>Macau</b>	29 (19.7%)	3 (9.6%)	26 (20.9%)
<b>Iceland</b>	1.3 (8.7%)	0.4 (-10.9%)	0.9 (18.8%)

Source: Ministry of Commerce of the People's Republic of China.



**Figure 2: The Spatial Landscape of China's Participation in the RTA**



**Figure 3: The Radiation Model of China's Participation in the RTA**