

# Fears and Strategies: The European Union, China and their Free Trade Agreements in East Asia

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## Abstract

The stalemate at the World Trade Organisation (WTO) Doha Round sparked a new wave of bilateral preferential and free trade agreements (FTAs). Nowhere has this been more evident than in the Asia Pacific region. Whilst there are economic reasons for FTAs, these are less efficient and more complex than multilateral agreements and most have had fairly small economic impacts. This article compares the strategies of a newcomer to the FTA arena, China, and the actor with the most cumulative FTAs, the European Union. It ponders on the different reasons informing their strategies and on how these may be affecting each other. It also considers the role of competitive fears and competitive diffusion in the formulation of their policies.

## Keywords

Free Trade Agreements; EU trade policy; Competition; China; ASEAN

STUDIED LARGELY BY ECONOMISTS WHO HAVE BEEN CONCERNED WITH THE TECHNICAL and costly effects of a complex 'spaghetti bowl' of tariffs, rules of origin and regulations (Baldwin 2006), free trade agreements (FTAs) have been viewed as both stumbling blocs (Krugman 1991, 1993; Thurow 1992; Baldwin 1993, 2007; Bhagwati 1994, 2008) and stepping stones (Wei and Frankel 1996; Dent 2003) to successful global economic liberalisation via the World Trade Organisation (WTO) within a debate on the compatibility of bilateral and multilateral liberalisation (Lamy 2002; Mansfield and Milner 1999).

This literature shares the assumption that free trade and liberalisation lead to growth. To substantiate this, models concerned with 'trade diversion' and 'trade creation' effects produced by lowering tariffs and non-tariff barriers have been developed, since Viner (1950) introduced the terms. Recent models, like Baldwin's (1993) 'domino effect', suggest outsiders to FTAs will want to become insiders, thereby expanding free trade. Similarly, Grossman and Helpman (1995) claim that trade diversion provides the principal motive for forming FTAs. As liberalisation extends via FTAs, states should experience positive welfare gains.

However, as Hallaert (2008) demonstrates, predicted welfare gains from bilateral FTAs tend to be overestimated given the time-lag in updating databases. He argues that gains obtained by party A in a FTA with B are quickly eroded if party B engages in a FTA with a competitor party C. The CGE (Computable General Equilibrium) models used to predict outcomes are also problematic given lack of firm-specific data, difficulties considering foreign direct investment (FDI) changes and knowledge transfers (Urata and Kiyota 2003: 22) and require arbitrary choices for implementation that affect results (Baldwin and

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Venables 1995), with forecasts often being off the mark (De Rosa and Gilbert, 2005). Improved models continue to be used in feasibility studies for policy-makers, and despite predicting marginal outcomes, policymakers continue to support FTAs. Ravenhill (2003) has documented meagre welfare results of bilateral FTAs in Asia, and studies estimating outcomes of FTAs between the European Union (EU) and Asian states also reflect this tendency (see IBM 2008; ECORYS 2009). However, as Ahearn (2010: 23) points out in reference to the EU and the United States of America (USA), FTAs with smaller partners may produce meagre overall outcomes, but this does not mean that individual companies and workers have not benefited or that exports have not risen at faster rates, but that in the aggregate many other factors other than FTAs may be determining how well each side does overall. The crux of the matter is that overall welfare gains predicted by the models are asymmetrically distributed, with some sectors winning substantial benefits from liberalisation and FTAs, and others losing out, resulting in lacklustre net gains for the economy as a whole.

Despite meagre results since the early 2000s, FTAs have multiplied, especially in the Americas and Asia Pacific. This new wave of FTAs even involves states traditionally committed to multilateral liberalisation, and is characterised by agreements between developed and developing states, cross-regional negotiations, and faster negotiations (Fiorentino *et al.* 2006). In this environment, analyses of the proliferation of FTAs are beginning to consider political motivations, rather than just economic projections and models, as regional blocs closed off to outsiders have not emerged (Hanson 1998), and the welfare outcomes are limited, casting doubts on purely economic rationales.

FTAs have been conceptualised as strategic responses to globalisation (Woolcock 2003), and interim tools in the hands of powerful players. Bhagwati (1994), for example, has coined the idea of a 'selfish hegemon' in reference to the USA, which while wedded to multilateral outcomes, uses the bilateral approach as a bargaining strategy to divide the non-hegemonic governments and improve the final multilateral outcome in favour of its own preferences. The EU's strategy clearly aims at achieving WTO-plus compromises and partners who will then defend these at the WTO. Its FTAs contain clauses for mutual support in multilateral fora, and the EU remains committed to both multilateral and bilateral liberalisation (De Gucht 2010b). Aggarwal and Urata's (2006) volume on agreements in the Asia Pacific, whilst rooted in the 'stepping stone-stumbling block' debate, focuses on political motivations for their pursuit, including learning processes, locking in domestic liberalisation reforms, sending signals to other potential FTA partners and strengthening their position in other negotiations (see also Ravenhill 2003).

Urata (2005) argues that the flurry of Asian FTAs was a response to the US turn to FTAs with NAFTA (1994), WTO Doha round difficulties, and a way to gain improvements on existing WTO commitments, as these new FTAs typically include facilitation of foreign trade and of investment, as well as economic and technical cooperation. He further demonstrates that FTAs in East Asia have a political intention; used by some (Association of Southeast Asian Nations (ASEAN)) to promote greater regional integration, by others (China, Japan) as a way of strengthening their ties with ASEAN and other newly industrialised economies as they vie for leadership, and as a way of promoting liberalisation and domestic reforms using external commitments as a way of circumventing domestic opposition in the aftermath of the 1997 Asian financial crisis. Ravenhill (2003), likewise, emphasises how FTAs are a mechanism to attain liberalisation less painfully by enabling the protection of some sectors, thus weakening domestic interests normally opposed to liberalisation. Fernandez (1997) argues that non-traditional gains from FTAs can also create new winners to counter the influence of domestic groups opposed to liberalisation. Ironically, it is those excluded sectors that would produce the highest welfare gains if they were included within the agreements (Wonnacott and Lutz 1989). For this reason, economists tend to

oppose limited FTAs (Sally 2005: 41). Solis and Katada (2009) offer an appealing alternative explanation in the form of ideational diffusion in the spread of FTAs, whereby states are emulating each other's policies. Significantly, they argue that a key element of this is competitive diffusion whereby the policy is implemented in view of what competitors do. They also find evidence of FTAs as tools for diplomatic power, which could explain why FTAs have not developed between the largest economies (EU, China, USA, Japan) but instead between these and smaller players or between smaller economies, as they compete for influence. Ironically, it would be FTAs between these major economies that could have the greatest welfare gains for them. The following discussion of the EU's and China's FTA strategies in East Asia reveals clear elements of this competitive diffusion.

### The EU's FTA Strategy

In 1994, the European Commission launched its 'New Asia Strategy'. This dovetailed in time with the US proposal within the framework of Asia-Pacific Economic Cooperation (APEC) to negotiate a FTA. Given APEC's commitment to 'open regionalism', the FTA never materialised, but it served to ignite EU concern with losing out to the USA in the region. At the same time, DG RELEX 1B produced a strategy for Latin America, with a more ambitious agenda than its Asia Strategy, and which was also a response to the creation of NAFTA and the US launch of the Free Trade Area of the Americas (which also failed to materialise) (Bessa-Rodrigues 1999; Garcia 2008). At the time, FTA developments within the Western hemisphere appeared a more imminent threat to future EU commercial access to the region, and elicited a stronger response than developments in Asia.

Furthermore, the EU's FTA strategy in the 1990s lacked an overarching framework, which when combined with the then geographically defined DGs for External Relations led to each commissioner sponsoring each FTA as a way of increasing his patch of power (Peterson and Bomberg 1999: 104). Spanish Commissioner Manuel Marin in DG 1B had responsibility over Latin America, Asia, and the Mediterranean. Whilst his DG promoted initiatives for all regions, his personal efforts were geared towards the Mediterranean and negotiations for an Association Agreement (inclusive of FTA) with Mercosur and Chile. These projects were of great symbolic, economic and strategic significance to Spain, and cornerstones of Spain's 1995 EU Presidency (Garcia 2008:121).

Evidence of DG 1B's hazier vision for Asia is found in the 'New Asia Strategy', which acknowledged the cultural differences between the regions and the need to foster understanding and greater links. A key way this has been implemented is through the Asia-Europe Meeting (ASEM), which was the brainchild of Singaporean Prime Minister Goh Chok Tong who proposed it in 1994 (Ravenhill 2009: 218). This forum has taken a less formally institutionalist approach than the EU's relations with other regions, which reflects the more voluntary nature of regional cooperation in the East and South East Asian region (Ravenhill 2009). ASEM has been a useful instrument for furthering the EU's agenda in terms of building trust. Its associated business forum has facilitated exchanges between EU and Asian business leaders and enhanced trade and investment. However, progress on the negotiation of specific instruments for the facilitation of investment has been protracted, partly due to the diversity amongst the Asian partners. Attempts by the EU to utilise the forum to further the EU's agenda of international human rights and conflict resolution<sup>1</sup> (e.g. Burma/Myanmar)<sup>2</sup> have likewise proven unsuccessful, but have contributed to generating a greater sense of community in South East Asia (Manea 2008).

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<sup>1</sup> On human rights in EU foreign policy, see King (1999), Lucarelli and Manners (2006), Youngs (2004).

<sup>2</sup> In 1990, the State Law and Order Council in Burma/Myanmar refused to accept electoral results, and clamped down on opposition, notably Aung San Suu Kyi, who was later placed under house arrest for 15 years and was released on 13 November 2010 after much international support for her cause.

Myanmar illustrates the EU's commitment to furthering its ties with ASEAN despite the challenge of reconciling this with its views on democracy and human rights promotion. After the Junta take-over, the EU adopted a Common Position. Upgraded in 1996 at the behest of Nordic states, the Position includes an arms embargo, visa ban, and a prohibition to invest in state-owned enterprises and the suspension of high-level visits to Myanmar (European Commission 2007: 20). When Myanmar entered ASEAN, the EU opposed and boycotted a technical meeting of the EU and ASEAN in 1997, but its interest in stronger economic ties with a region poised to be highly significant meant it soon re-engaged with ASEAN. With the Amsterdam Treaty of 1997, fundamental rights became part of Union Law as a principle, making relations with Myanmar even more difficult (Petersson 2006: 567).<sup>3</sup> The EU has, therefore, not admitted Myanmar into ASEM or its agreement with ASEAN.<sup>4</sup> When Malaysia threatened to boycott the second ASEM summit in 1998 over this, the EU acquiesced to leave out any mention of human rights in the summit in exchange for Malaysia's attendance (King 1999: 334). This is a clear example of the challenges of reconciling commercial interests and the ethical foreign policy rhetoric the EU imposed on itself in its Treaties, and shows the importance the EU attaches to its relations with ASEAN.

Notwithstanding the political dialogue and cooperation, trade and investment have been areas where the relationship between both regions has experienced spectacular growth. Whilst the Asian financial crisis of 1997 and the disappointment with the US and APEC's responses encouraged Asian leaders to activate new mechanisms for regional cooperation ('Chiang Mai' Initiative, Japanese calls for Asian Monetary Fund), of which the ASEAN-Plus-Three (APT) would become the most significant, the EU stood by, more preoccupied with the launch of the Euro and Eastern enlargement. In trade policy, the arrival of Pascal Lamy as Commissioner in 1999 provoked a reversal in EU policy towards a prioritisation of multilateral liberalisation through the WTO (Lamy 2002). Indeed, during the time Lamy was at the helm, no new FTAs were brought onto the EU agenda.

Whilst the EU operated within these self-imposed constraints, Asia experienced a proliferation of FTAs that detractors believe complicates the operations of production networks (Ravenhill 2009: 216). As talks collapsed at the WTO in 2003, the USA undertook an aggressive policy of FTA negotiations. With the appointment of Peter Mandelson as Trade Commissioner in 2004, the EU also changed its policy to simultaneous multilateral and bilateral liberalisation and, in the 2006 'Global Europe' Trade strategy, it moved away from the previous sustainable development discourse to a more realist discourse of competitiveness, in line with the EU's internal Lisbon Agenda for competitiveness which had been re-launched in 2005.

The language in the 'Global Europe' document exudes a sense of urgency. It prioritises Asia, acknowledging the EU's late response in this area (DG Trade 2006a). It reveals concern about potential losses given third party FTAs and proposes new FTA initiatives with South Korea and ASEAN. Strengthening strategic links with important emerging markets also appears to be a key motivating factor behind EU FTAs with Mercosur, but more especially South East Asia and India. Here the aim is simply to strengthen trade and investment links with markets that will be important in the future (Woolcock 2007:4), thus attempting to pre-empt any bilateral deals that these future markets may make with EU

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<sup>3</sup> ASEAN's founding treaty of 1967 states the principle of non-interference in domestic matters, so refusing to admit Myanmar would have contravened ASEAN's treaties (Petersson 2006: 567).

<sup>4</sup> The fragmented nature of EU policy is exemplified by the fact that the Commission has defended EU private business interests that entered Myanmar prior to the coup (King 1999: 333; Pilger 1996), notably France's oil company Total. Egreteau argues that the inefficiency of EU sanctions responds to the lack of EU leverage in the state given a relatively small humanitarian involvement, and the state's greater economic ties with China and South East Asia. He points to a split between the political elites of some states heavily influenced by public opinion and the Burmese in exile lobby (UK, Scandinavian and some Central EU states) in favour of ostracising the regime, and others (France, Germany) favouring engagement given the lack of results from the sanctions.

competitors. Even if the sustainability studies indicate meagre overall welfare gains from these FTAs (IBM 2008; ECORYS 2009; Decreux *et al.* 2010), the fear of being left out of the FTA networks and perhaps having some exporters at a disadvantage to US or Asian exporters elicits such policy responses. As a general rule, the EU's FTA policy requires a clear economic case for any FTA, which can generally be interpreted as meaning some real increase in market access in addition to that achieved at the multilateral level in the WTO (Woolcock 2007: 4). Given the asymmetric outcomes of FTAs, any FTA will produce gains for some sectors, especially those facing greatest restrictions, so despite the limited overall welfare gains, it is normally possible to make some economic case. The sectors the EU seeks to benefit through FTAs are service provision and the strengthening of international rules such as intellectual property or safety standards, an aim which is given prominence in 'Global Europe', on which the EU was unable to forge international consensus at the WTO. Making an economic case is in itself a political act. In 2004, the EU refused to commence FTA negotiations with Singapore and Central America based on the absence of an economic case (DG Trade interview 2006). After 'Global Europe', and the fact that both of these had signed FTAs with the USA, the EU proceeded to enter negotiations and suddenly found their limited markets much more appealing. It appears that the economic case is less about the actual gains and more about competitors potentially gaining an advantage. In other words, it could be viewed as a race to maintain the *status quo* amongst the major players, at a time when agreeing multilateral rules appears more complicated.

As part of the 'Global Europe' strategy, the EU, which was already concerned about the moves towards an APT, began its own negotiations with the parties of this agreement. Between 2007 and 2009, it negotiated a comprehensive Association Agreement with South Korea signed in October 2010 and due to enter in force in July 2011 after national ratifications and assuming the European Parliament (EP) grants consent.<sup>5</sup> South Korea is the EU's eighth largest trading partner (2.3 per cent of EU trade) and the EU is Korea's second export destination. GCE models predict a rise in Korean exports to the EU of 34 per cent and of 82 per cent for EU exports (Decreux *et al.* 2010: 6). Despite this, given the openness of both economies and the asymmetrical effects of FTAs across sectors, the estimated welfare effects on GDP of this agreement are 0.08 per cent for the EU and between 0.4 and 2 per cent for South Korea, as a result of potential higher FDI (IBM 2008: 13). EU companies have significant problems accessing and operating in the South Korean market due to stringent standards and testing requirements for products and services often creating barriers to trade, despite being the largest investor in Korea since 1962 (DG Trade 2010) and some of the expected gains from the FTA derive from negotiated improvements in this respect.

Despite being the EU's flagship FTA within its 'Global Europe' strategy, it has been marred by controversy. Trade is one of the most communitarised policies of the EU, with clear delegation of powers to the Commission to act on the member states' behalf once they have consensually decided upon a mandate. Yet, the initial formation of the policy is subject to conflicting interests: member states and sectoral preferences push in different directions. Matthew Baldwin (2006) argues the liberal North versus protectionist South dichotomy is too gross a generalisation, as states' preferences vary across time and issues, and also acknowledges the industrial and non-governmental organisations' pressures on the Commission. Combined with the fact that, as the longest standing viable foreign policy tool of the EU (previously EC), trade policy has been explicitly linked to foreign policy goals (M. Baldwin 2006: 938), at times at loggerheads with commercial demands,

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<sup>5</sup> This marks the first post-Lisbon Treaty agreement which granted the EP greater powers in the consent procedure by adopting the ordinary legislative procedure for the regulations for the implementation of the agreements (see Woolcock 2008).

the EU is truly a “conflicted power” in its trade policy (Meunier and Nicolaidis 2006).<sup>6</sup> Even after the Commission has negotiated with partners, member states must ratify the deal and the EP grant consent. In the EU-Korea case, the Council’s approval was delayed given Italy’s wish for more protection for the automobile industry. The vote at the EP has also been postponed to December 2010, again due to lobbying by the automobile sector, concerns over concessions over rules of origin for components from third parties, the EP’s use of its new Treaty powers to gain a role in commencing safeguard procedures (*European Voice* 21.10.2010) and its (and manufacturers’) fears that some concessions could be used in other negotiations with more detrimental outcomes (e.g. with ASEAN or China) (European Parliament 2009: 9).

This has provoked interesting consequences. Fearing that its manufacturers will be disadvantaged once the EU reduces tariffs on Korean manufactures, Japan has asked the EU to initiate FTA negotiations, in line with ‘domino effect’ predictions (Faletti 2010). The EU, despite its new focus on Asia, has refused, partly to facilitate the passage of the Korea FTA in the EP without fears of extending those advantages to Japan, and partly because it has chosen to focus on the markets with greater growth potential in the region (ASEAN, Korea) (*Japan Today*, 01.05.2010). Furthermore, Japanese tariffs are low and the EU engages in a regulatory dialogue with Japan on non-tariff barriers to trade already, although given the current FTA furore it seems likely that the Commission will seek a negotiating mandate once the EU-Korea FTA has been duly ratified.

ASEAN is the other cornerstone of the EU’s East Asia FTA strategy. The interim report of the Sustainability Assessment suggests overall benefits with some sector-specific negative outcomes. In a comprehensive FTA scenario, welfare gains as percentage of GDP are estimated at 0.23 per cent for the EU and 3.66 to 15.27 per cent for different ASEAN states, and in the case of a restrictive FTA at 0.02 per cent and 0.08-1.92 per cent respectively (ECORYS 2009: 18), with ASEAN states gaining additional market access to the EU and European transnational corporations strengthening their impact in the ASEAN region. Whilst the EU runs a trade deficit with ASEAN, its fifth trade partner representing 5.1 per cent of EU trade, investment opportunities in the region have been key in the relationship.

In 2003, ASEAN asked the EU to consider an FTA, but the EU was reluctant as Lamy preferred the WTO, and the unsuccessful negotiations with MERCOSUR had made the Commission sceptical of ‘bloc-to-bloc’ negotiations (Robles 2008: 337). In 2005, Commissioner Mandelson asked a Vision Group to study upgrading EU-ASEAN relations and, in the 2006 Global Europe Strategy, an FTA with ASEAN was prioritised. Negotiations began in May 2007 and have progressed slowly, due to the differences amongst ASEAN members and the EU’s requirements that its FTAs encompass more than trade, but also investment, procurement, intellectual property rights, and a host of political clauses. This complicates FTA negotiations, and marks a sharp contrast with the US and Chinese approach. The Philippines, for example, signalled from the start that the political cooperation agreement would be problematic as it requires signatories to become members of the International Criminal Court ([bilaterals.org](http://bilaterals.org)).

Shifting from its previous trade strategy in prioritising multilateral and interregional negotiations (with ASEAN, Mercosur, Central America), which had even been characterised by some as “a doctrine of global policy based on interregionalism” (Soderbaum *et al.* 2005: 366, 371), Trade Commissioner De Gucht (since 2009) on a trip to South East Asia in March 2010 announced the launch of negotiations for FTAs with Singapore and with Vietnam. These are the states with which the EU already has closer economic ties and, according to the Sustainability Impact Assessment, Singapore is the ASEAN state that will gain the most

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<sup>6</sup> On EU trade policy-making, see Woolcock 2010; Meunier 2005; on the influence of interests, see Dur 2008; van den Hoven 2002.

in terms of an agreement with the EU, partly due to its policy of positioning itself as an East Asian hub (see Tay 2010). It is perhaps no coincidence that these two states are amongst the group of six ASEAN states who have already begun to implement their FTA with China.

The move to bilateral deals, which the EU is also undertaking in other parts of the world (negotiations with the Andean Community have resulted in EU-Colombia and EU-Peru FTAs), seems to reflect a more pragmatic approach to FTAs, as a bilateral deal will be easier to negotiate than a FTA with another regional grouping that often lacks the level of institutional unity in the negotiations that the European Commission has developed (Robles 2008). It is, however, a far cry from the EU's preferred strategy until the mid-2000s when it encouraged interested parties to further integrate in order to engage in fewer negotiations and to reap greater economic benefits from a FTA with a region rather than an individual state (DG Trade interview 2006). The bilateral approach does enable the EU to keep up mainly with US FTAs, and also China's and Japan's. In the particular case of the EU-ASEAN FTA, the bilateral approach would also allow European governments to avoid taking on any commitments that support the regime in Myanmar and also to deal with the economic heterogeneity among ASEAN members (bilaterals.org). Notwithstanding this, the EU remains intent on an eventual 'bloc-to-bloc' FTA with ASEAN as highlighted by De Gucht (2010a) himself:

The launch of FTA negotiations with Singapore, for us, marks the beginning of a deeper engagement with Asia, and in particular in our relations with the ASEAN region.

Although Singapore is the 'first one in', our door remains open for other ASEAN countries interested in negotiating a comprehensive free trade agreement with us. We are not available to do shallow FTAs, but we will be mindful of differences in levels of development.

### China's FTA Strategy

China's economic transformation into a market socialist economy and its consistent economic growth have been commented upon elsewhere (see Blecher 2010; Beeson 2007; Naughton 2007; Bramall 2000). A key aspect has been the focus on exports and the incorporation into global markets. Crucial to this was the accession of China into the WTO in late 2001. Despite internal conflict regarding the desirability of opening up the Chinese economy to foreign competition prior to accession, since joining the WTO, China's trade increased by 28 per cent yearly and FDI rose 7.5 per cent annually in the first five years following membership (Blecher 2010). China's export capacity has continued to spur complications with other partners. Cases of antidumping measures, quota restrictions and others have been brought up against it by its key trade partners, the USA and the EU (Moller and Kutkowski 2005; Brown 2007; Hufbauer *et al.* 2006; Comino 2007). Divergent interests of domestic constituencies, some of which are the investors producing goods for export in China, have led to complex and swaying EU responses to the rise of China (Shu 2010). The intricacies of these relations lie outside the scope of this article, but do provide a useful example of the sense of competitive fear that China's economic rise has triggered in the EU.

Despite being a late-comer to the FTA game, and as part of its strategy of market insertion, China has made rapid strides to extend a network of FTAs. Commentators agree that, like in the cases of the EU and the USA, FTAs have responded to economic and political rationales. Economically, China's aim has been to secure a stable regional market and commodity supplies (Hai and Li 2003; Urata 2005; Hufbauer and Wong 2005; Yan 2009), which build upon the ever-closer intra-industry trade-and-investment linkages in East Asia that inform the economic logic of region-wide FTAs (Sally 2005: 42; Tay 2010: 35).

Politically, China hoped to reassure neighbours of its peaceful rise, gain leadership in the region (Breslin 2009; Blecher 2010) and support for its 'one China' policy, as well as market economy recognition to limit others' use of antidumping procedures against it (Sally 2005).

The special free trade agreements with Hong Kong and Macau are part of the 'one state, two system' arrangements, and economically highly significant as Hong Kong represents China's fifth trade partner accounting for 8.5 per cent of China's trade in goods and services (WTO 2008 data). Wang (2004) argued that the long-term political benefits of these were to demonstrate an acceptable pattern for integrating Taiwan into the 'Greater China economic circle'. Subsequently, China and Taiwan signed a landmark Economic Cooperation Framework Agreement in June 2010 (*BBC News*, 29.06.2010), which builds upon trends of increased trade and investment (see Zhao and Tong 2009).

China's most significant FTA has been with ASEAN<sup>7</sup>: it forms the largest trading bloc by population size and encapsulates China's key strategic aims. Although the literature often starts with the critical juncture of the Asian Crisis of 1997 as the inflexion point in China's and the region's attitude towards Asian regionalism and cooperation (Tay 2010; Lijun 2003; Terada 2003; Blecher 2010), China's rapprochement to ASEAN predates that. In the late 1980s-1990s China engaged with ASEAN with the desire to ensure regional stability and foster economic growth, as it realised that the world was about to change into an eventual multipolar system (Cheng 1999). Lijun's (2003) work reliant on interviews with Chinese officials reveals a thoughtful long-term strategy beyond economic considerations in the China-ASEAN FTA (CAFTA), and a shift from scepticism to leadership in FTAs, enabled by increased involvement in the global economy after WTO accession (Zerui 2004).

CAFTA was a WTO-compliant way to offer East Asian economies trade preferences and curtail increased competition from China (Lijun 2003: 6-7). It was also part of China's policy of deeper economic relations in the region as a way of establishing trust and ensuring that the region's economic future is dependent on what happens in China (Breslin 2009: 820). Zhang and Tang (2005: 51) claim that China seeks to turn itself into the engine of regional growth as a market for products and provider of investment and technology. Since the 1997 Asian Crisis, this has become more evident. During the crisis, China surprised its neighbours by not devaluing its currency to undercut Southeast Asian exports, thus reassuring its neighbours of its 'peaceful rise' (Blecher 2010). It also became an important source of funds for the region. These trends have continued and China has displaced Japan's influence in the region and become ASEAN's first trade partner and a major investor (Blecher 2010: 194), and through this has enhanced its 'soft power' (Breslin 2009).

From a strategic perspective, CAFTA is a practical application of China's New Security Concept (announced by Jiang Zemin in 1996 at the Shanghai Cooperation Organisation inaugural meeting) advocating multipolarity, as well as peaceful dispute resolution, mutually beneficial economic contacts, and linking economic progress to security in Asia. Chinese chief WTO negotiator Long Yongtu emphasises that CAFTA is also aimed at East Asia integration to protect against economic shocks in globalisation (Lijun 2003: 8). A key development in this respect has been the APT, which was driven by two key factors in the late 1990s: China's successful attempts to consolidate its influence in Southeast Asia (Beeson 2007: 229) and the concerns this caused in Japan; and the Asian financial crisis and the inappropriate responses of the international community, which led Japan to the

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<sup>7</sup> Negotiated between 2002 and 2007, in effect since January 2010 with the five most advanced ASEAN economies.



realisation that there was a consensus that the time was right for East Asian regionalism to tackle regional problems (Terada 2003).<sup>8</sup>

Tense Sino-Japanese relations given historical distrust, ambiguity over Taiwan and disputed territories and Japan's closeness to the USA (Drifter 2009) made a China-Japan axis for regional integration impossible. Chinese strategists, therefore, took the view that "it is easier for China to start the ball rolling by working first with ASEAN", which would be easier than with Japan or Korea (Hai and Li 2003) and hoped the CAFTA would cause "chain reactions" to produce "multilayered arrangements" (such as several ASEAN Plus Ones), and "gradually move to a unique regional framework" in East Asia. The 'chain reactions' have taken place: Japan reacted to the CAFTA by negotiating its own agreement with ASEAN states<sup>9</sup> and ASEAN by accelerating its economic integration and the potential ASEAN Economic Community (Lijun 2003: 11). It seems that competition between China and Japan may actually be encouraging the development of a dense web of bilateral trade deals that is effectively "networking the region" (Dent 2003) and forcing closer ties and working relations even between reluctant partners like Japan and China (Beeson 2007: 235). Fears of losing out from FTAs established by other parties sparking new FTAs lends credence to Baldwin's (1993) 'domino effect' characterisation of the FTA phenomenon. At the same time as competitors sign catch-up FTA deals, the welfare gains from the first FTA diminish (Hallaert 2008), further encouraging the original parties to seek advantages in other markets by embarking upon further FTAs. Thus, we find a collusion of factors fostering the expansion of the 'noodle bowl'.

As an instigator of CAFTA, Chinese tactics, engaging with the more enthusiastic ASEAN members first to pressure more reluctant members to follow suit, reveals keen leadership (Lijun 2003: 15) and accounts for the conclusion of earlier FTAs with Thailand (2003) and Singapore (2008). Interestingly, this is the approach that is now being followed by the EU in the region, as well as in Latin America. China's plan has always been to follow this initial FTA with FTAs with Japan and South Korea<sup>10</sup>, its major partners in the region, and to negotiate with India in the Southwest, as part of its aims to be the political and economic driving force in the region (Zerui 2004).<sup>11</sup> Politically, this strategy is enhancing China's 'soft power' (Breslin 2009) by ensuring access to the Chinese market for friendly states, and by using emerging multilateral structures as a way of pursuing 'commercial diplomacy' to compete with Japan and the US for support and even dominance in the region (Hoadley and Yang 2007).

Given China's export-led economic growth strategy, it is unsurprising that it has also engaged in FTAs with partners further afield, such as Niger (2005), Chile (2006), New Zealand or Peru (2008), and that negotiations are underway with Australia, Pakistan, the Southern Africa Customs Union, Norway, Costa Rica and the Gulf Cooperation Council (MOFCOM.cn 2010). It is perhaps no coincidence that all of these are on the one hand markets for Chinese mass-produced manufactures and purveyors of raw materials necessary for the continued development of China's economy. From this perspective the economic rationale for such FTAs seems straightforward, as indeed market access and securing commodity imports are key economic objectives of China-driven FTAs (Zerui 2004).

From a more strategic perspective, a key component of China's FTA strategy is to get wider acceptance of market-economy status, especially with anti-dumping actions in

<sup>8</sup> On Asian crisis and regionalism, see Tay, 2010; Beeson, 2007.

<sup>9</sup> Negotiations ended in 2008. South Korea negotiated its FTA with ASEAN in 2007.

<sup>10</sup> Feasibility studies for China-South Korea, China-Japan-South Korea FTAs are ongoing as of October 2010.

<sup>11</sup> India remains concerned about negative effects for its competitiveness from a FTA with China and only exploratory talks have taken place (bilaretals.org 2010).

mind. China is pushing hard for removal of non-market economy status in the WTO, and bilaterally with the EU and the USA. Singapore, Malaysia, Thailand, New Zealand and Australia have already accorded China market-economy status, as did other ASEAN states in 2004. It is no accident that China is in (or talking about) FTA negotiations with the countries that have conceded market-economy status (Sally 2005: 43).

There is another element to notice in these agreements. By and large, all of China's out-of-region FTA counterparts already had existing FTAs with the EU, and in many cases increasingly with the USA as well. Norway is part of the European Economic Area, South Africa has had a FTA with the EU since 1999, Chile has FTAs with both the EU (2002) and the USA (2003). The Gulf Cooperation Council has an Economic Cooperation Agreement with the EU<sup>12</sup>, and Peru concluded the negotiations of a FTA with the EU in early 2010 and signed one with the USA in 2005. This hints at the increasing competition between these major players for securing FTAs, despite the scarce economic welfare outcomes these have produced thus far (see Table 1 for a comparison), fuelled instead by fears of loss of competitiveness, and also as a political tool to extend their influence in other parts of the world.

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<sup>12</sup> The agreement commits the parties to negotiate an FTA, after early standstill negotiations resumed in 2002 (EU External Action 2010).

**Table 1:** Comparative timeline of FTAs

	CHINA (start)	CHINA (conclude)	EU (start)	EU (conclude)	USA (start)	USA (conclude)
ASEAN	2001	2007(in force 2010*)	2007		(relation through APEC)	
HONG KONG		2003				
MACAO		2003				
THAILAND		2003	(ASEAN)		2004	
SINGAPORE		2008	2010			2003 (in force 2004)
S KOREA			2007	2009 (undergoing ratification)	2006	2007 (not ratified)
MALAYSIA	(ASEAN)		(ASEAN)		2006 (prior trade investment framework agreement 2004)	
NEW ZEALAND		2008				
AUSTRALIA	2005					2004
PAKISTAN		2006				
INDIA			2007			
CHILE		2006	1999-2000	2002 (in force 2003)	2000	2003 (in force 2004)
PERU		2008	2007  (start EU- Andean Community)	2010 (signed Peru and Colombia)		2005
NIGER		2005	(Cotonou EPAs)			

ASEAN: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam

\*2010 for Brunei Darussalam, Malaysia, Singapore, Philippines, Thailand, Indonesia; 2015 for others

Sources: European Commission DG Trade website, US Trade Representative website, ASEANWEB (2010)

## Who leads the way? Competitive fears and FTA strategies

China and the EU have become inextricably linked. The EU is China's first trade partner accounting for 16.4 per cent of China's global trade (WTO 2008 data). China is the first importer to the EU with a 16 per cent share. It is also the fourth market for EU exports accounting for six per cent of EU exports (DG Trade 2008 data). Whilst the EU runs large trade deficits in goods with China, especially in machinery and textiles, it runs significant surpluses in trade in services (DG Trade 2008 data), and remains a key investor in China, whilst increasingly receiving FDI from China. The two economies, the three if we include the USA, are inextricably linked, at least for the time being.

Such interdependencies and large volume of trade have not stopped the EU from pushing for greater market access. The European Commission's 2006 Document *Global Europe: EU-China Trade and Investment. Competition and Partnership* uses rather charged language, calling for China to "use its growing influence to champion open markets and fair competition" (DG Trade 2006b: 2). Whilst it acknowledges how many EU companies benefit from lower costs in China and from cheap exports, it lists grievances against increasing non-tariff barriers in China and a 'China first' approach to government procurement, which, the EU document claims, contravenes WTO obligations (DG Trade 2006b: 7). It accuses China of unfair competitive advantages given low environmental and social costs, of distorting raw materials markets by its large purchases and restrictions on its exports of rare earth minerals, coke, and coal (DG Trade 2006b: 9). Finally, the document proposes dialogue first as a solution to disputes and the conflicts listed previously. In light of this, negotiations for a Partnership and Cooperation Agreement between the EU and China to replace the outdated 1985 Trade and Cooperation Agreement commenced in January 2007. Given levels of trade and investment between the parties, this agreement (more limited in scope and political aspects than those the EU negotiated with other partners) does have the potential to provide significant economic advantages, much more so than the FTAs with ASEAN or other states in the region. Indeed, 'getting China right' remains the cornerstone of the EU's strategy in the region.

Despite appearances, the fear of the rise of China, and highly mediatised EU-China trade wars, the EU and China have much in common. Since the early 1990s, both have been vocal advocates of a multilateral system of global governance to counter US dominance, and both have presented themselves as alternative markets and sources of FDI and aid. Both have also played the benign power card of economic powers without the traditional references to military power that defined the superpowers of the Cold War.<sup>13</sup>

In terms of economic power, given its size and importance, China has become a key power irrespective of its actions. Like the EU, it has seized on the attraction of its market to link its external economic policies to foreign policy aims. Unlike the EU, these foreign policy aims have been limited to a large extent to international support at the United Nations for its 'one China policy' and granting it market economy status. Thus, China's economic development policy has been much maligned in the West as being focused on Chinese access to natural resources and providing a 'no strings attached' (other than support of 'one China policy') alternative to EU and international bodies' conditional aid (*BBC News*, 26.06.06).<sup>14</sup>

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<sup>13</sup> On the EU's steps to militarisation through the ESDP, see Biscop 2004; Howorth 2007. China has increased military spending and caused concerns over the Taiwan Straits, yet seems focused on a 'peaceful rise' and Hu Jintao's 'harmonious society' (see Lampton 2007; Blecher 2010).

<sup>14</sup> Brautigam (2009) offers a more nuanced view of Chinese aid combining access to resources with developmental projects.

With regard to its FTA strategy, Chinese FTAs, like the US ones, focus on core economic aspects: trade facilitation through reduction of existing tariffs, dismantling of non-tariff barriers, greater access to foreign direct investment and the provision of services. They are pragmatic FTAs focused on opening goods and services markets and often ignoring environmental, labour and intellectual property matters (Hufbauer and Wong 2005: 3), unlike US and EU FTAs. Furthermore, they include a political agreement component since the 1990s, linked to the EU's international aim of democracy promotion and respect for human rights, one of the elements that has led to one characterisation of the EU as a 'normative power' (Manners 2002).<sup>15</sup>

Current EU fourth-generation FTAs have expanded the political agreement to also incorporate non-nuclear proliferation, support of the International Criminal Court, cooperation at multilateral fora, and supporting the EU's core international aspirations. On the economic side, they are designed to be 'WTO-plus' agreements that include liberalisation in financial services, public procurement, and EU intellectual property rights, which have proven controversial at the WTO. This accounts for the lengthier negotiating processes the EU engages in. This could be viewed as a comparative disadvantage *vis-à-vis* China's more focused approach, which can deliver speedier results. However, as De Gucht (2010) has pointed out, the EU is only interested in deep agreements.<sup>16</sup> The advantage of this approach is that, once a deal is struck, as it is more comprehensive in terms of sectoral coverage, welfare gains could be greater and the EU will once again have a competitive edge over others that have negotiated narrower FTAs. It is also important to note that, in terms of strategy, the EU's approach to its key partners and competitors is also far narrower. Its economic relations with the USA and China are dominated by sectoral agreements rather than the comprehensive FTAs with other partners, and political conditionality is conspicuous for its absence.

China's success in negotiating CAFTA, its greater understanding of the region, and lesser focus on conditionality confer it an advantage with respect to the EU. The EU has clearly been a latecomer to the FTA game in Asia, though it seems to be gaining momentum and the deeper scope of its deals may well secure it a more comfortable position in the future. What seems clear, however, is that, within the East Asian region, China's FTA strategy, with ASEAN, ASEAN-plus-ones was clearly designed in the early 2000s, with independence from EU and US agendas in the region at the time. In this part of the world, it has been the EU that appears to be following others' lead. APT certainly ruffled feathers in Brussels (DG Trade interview 2006). However, it is important to notice that it did not initially provoke any change in the EU's strategy. It was not until 2007 that the EU began to negotiate with ASEAN, as a bloc, still pursuing its interregional reflexes, and only in 2010 did it launch individual negotiations with Singapore and Vietnam. Both are included in CAFTA, and Singapore has also signed a FTA with the USA. It was also in 2007 that the EU launched negotiations with South Korea. At the time of writing, South Korea is still negotiating FTAs with ASEAN, and will likely in the future also engage in one with China, but it was the fact that South Korea has negotiated an FTA with the USA that triggered the EU response.

Outside the East Asian region, it appears that both China and the EU are following on from the US turn to bilateral FTAs from the early 2000s. China has negotiated a FTA with Chile, which already had FTAs with the EU and the USA, and with Peru, which likewise has a FTA with the USA. The EU, again, with its integrationist pursuits, decided to launch negotiations with the Andean Community in 2007, by which time Peru had already negotiated a FTA with the USA, and in view of difficult progress then switched to bilateral deals with Peru

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<sup>15</sup> The EU's record with regard to upholding these values has been mixed (Youngs 2004).

<sup>16</sup> Young and Peterson (2006) explain the EU's deep trade agenda as a response to a new trade environment where 'behind-the-doors' issues are more relevant, there are more actors (parliaments, non-governmental organisations) and EU and US dominance is challenged by the newly industrialised and developing states.

and Colombia. Likewise, apart from the negotiations with ASEAN, EU bilateral FTAs since 2007 seem to be prioritising those partners already engaged in FTAs with the USA. As both China and the EU are negotiating FTAs to avoid perceived potential losses to the USA, it is no surprise that they have engaged in negotiations with some of the same partners. They also seem to be acting in a manner consistent with 'competitive diffusion' whereby the policy is enacted in view of what competitors do, and indeed in many markets the USA is China's and the EU's main competitor (Solis and Katada 2009). Indeed, the USA responded to China's overtures with ASEAN and APT with its own FTAs in the region, hoping to prevent China's domination of the regional integration process in East Asia (Quiliconi and Wise 2009). Mochizuki (2009) finds that the result of seeking influence through FTAs has meant that the large players have not used FTAs among themselves to counter competitive pressures, but have instead signed them with smaller states to hedge against negative trends, and, thus, so far, large power competition has prevented the predominance of any hegemonic FTA project. In terms of the main players in a multipolar world, so far the "FTA process (...) more closely resembles fingers reaching idiosyncratically around the globe than the formation of politico-economic blocs centred respectively on Beijing, Brussels and Washington" (Hufbauer and Wong 2005: 12).

## Conclusion

Actors engage in FTAs for a variety of political and economic reasons. Within the East Asia region, China has clearly acted as an initiator of the FTA frenzy with its negotiations with ASEAN and APT. The economic and strategic significance of the region is clear, and China has used its FTA network to further link the region's economic future to its own, to reassure neighbours of its peaceful rise and gain support for some of its key international objectives. As a latecomer into the region, EU FTAs have prioritised those states with greatest growth potential and which already had FTAs with its key competitors, the USA and China, in an attempt to allay any possible future losses of market share or advantages to EU businesses in the region. Clearly, competitive diffusion is taking place as the main players emulate their strategies, as is the race to avoid perceived potential losses in the future. Given the meagre overall welfare effects of these FTAs, it appears that maintaining the *status quo* and guaranteeing future market access, as well as economic and political balance, are more important than the actual absolute economic welfare gains.

The stalemate at the WTO has been a key external factor in focusing all actors on FTAs. Internal factors to allow this change of policy have been very different. In China the enforced liberalisation reforms undertaken to join the WTO helped to erode internal opposition to liberalisation through FTAs. In the EU, it was only once DG Trade's leadership changed in late 2004, combined with the greater focus on competition, that FTAs with East Asia became politically viable. Whilst too early to predict, it seems likely that China, the EU and the USA will end up with a similar network of FTAs in East Asia, and possibly elsewhere too. The EU's 'deep trade' agenda in its FTAs may eventually help it to increase its international influence and solidity of alliances and export of its rules. However, given the differences with Chinese and US FTAs, it may lead to the complex 'noodle bowl' regulatory scenarios economists fear (Ravenhill 2009). De Vos (2010) foresees a world with greater tensions over competing models of trade, monetary issues and capitalism, potentially acquiring greater political and geo-strategic significance in the wake of the financial and economic crisis (from 2008 until recently), and argues that whilst a complete reversal to protectionism has not occurred, increasingly states are relying on support to strategic businesses through loans, bail-outs, and more recourse to industrial strategy for expansion. How will this new reality interplay with the FTAs? Future FTAs may become narrower in scope as a result of more protectionism, but a revocation of existing ones seems highly unlikely. Whatever the future holds, FTAs have created a complex system of

trade and investment rules alongside the WTO. Lacking the same degree of institutional tradition and capacity, FTAs represent a more flexible, faster, and possibly less contentious response to the challenges of a global economy and competitive fears. Attracting less media attention and public scrutiny, these developments beg the question: what type of new economic governance is emerging through FTAs, and what economic, political and social consequences will it entail?

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