

China Joins Global Governance

Cooperation and Contentions

Edited by Mingjiang Li

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II

CHINA AND GLOBAL ECONOMIC GOVERNANCE

Bargaining for More: China's Initiatives for Regional Free Trade in East Asia

June Park

This chapter analyzes China's initiatives in bilateral free trade in the East Asian region by examining free trade and economic partnership agreements. Despite potential benefits of a multilateral regional free trade in East Asia, bilateral agreements have been the preferred method for trade agreements and investment treaties in the region. While trade negotiations are lagging at the multilateral level in the Doha Round, countries have found better alternatives to tackle with trade issues—via bilateral free trade agreements (FTA) and economic partnership agreements (EPA), which provide partnering states with the opportunity for bargains and options to protect specific industries and agricultural sectors. The research proceeds in the following four segments: This research will first account for the motives and the driving force behind China's active engagement in trade deals via EPAs, and provide detailed case studies of China's EPAs; the second section will analyze regional trade dynamics with comparative perspectives from neighboring economies of the region—Japan and Korea. The third section will focus on the dilemmas of China's trade policies, in which China's aggressive positioning in the WTO trade disputes and the abuse of trade policies may dim China's prospective role in global and regional governance by examining reciprocal responses from trading partners in the region and at the multilateral level. The chapter will conclude with the prospects of the two-faced dimensions of China's foreign economic policy via trade bargaining.

In uncovering the initiatives and dilemmas of China's regional expansion of free trade, this research uses a process-tracing method by providing economic and financial statistics to support the arguments raised throughout the chapter. The periodization of 1999–2012 (post–Asian Financial Crisis) will allow for a decade-long analysis including recent developments of China's initiatives in regional and global trade. This given periodization will encompass the time frame from post–Asian Financial

Crisis of 1997–1998 and the Global Financial Crisis of 2008–2010, which have served as critical junctures for East Asian economies, including China.

THE BACKGROUND OF CHINA'S FREE TRADE AGREEMENTS

In the post–Cold War era, the profound impact of economic interdependence resulted in the expansion of regional trade networks across the neighboring countries in Northeast Asia, and the region benefited greatly from these changes. While the initial phase of East Asian economic integration was a reflection of state interests and pragmatic calculations that focused on growing intra-regional trade, a concomitant sense of community derived from mutual influence of states on one another. Such effects of internationalization on states' economic policies and institutional forms have been emphasized in the "second image reversed" literature of international political economy, which stresses the influence of international factors on domestic outcomes. Meanwhile, powerful economies still make the rules for the global economy and shape regional order. The roles of sovereign states and their responses toward internationalization remain significant, particularly in the case of East Asia, in which bilateral relations continue to be important.

Following the Reform Era that began under Deng Xiaoping's rule in 1978, China has had remarkable progress in economic development and has transformed itself into the world's biggest manufacturing house. The economic transformation that occurred under the highly centralized and controlled government initiatives of the Chinese Communist Party (CCP) allowed it to serve as an increasingly attractive market for trade and manufacturing, owing to the most favorable conditions in factors of production any country has enjoyed in the past two decades: abundance of low-cost labor, huge landmass, and the ability to absorb and attract huge inflows of capital via foreign direct investment. Despite abrupt changes in the factors of production as the demands for wage increases and requests for improvement of working conditions are gradually evolving into social unrest and demonstrations in many parts of China, the Chinese government has nevertheless persistently pursued the goals of economic development as a priority agenda.

China's foreign economic policies remain strongly based on the Chinese government's agenda of economic growth. In previous decades, the regional trade network in East Asia had expanded in tandem with the economic growth of Japan and the Four Asian Tigers, with the United States as the main targeted market for sales across the Pacific. During the phase of economic recovery just after the World War II, Japan took the lead and had been at the forefront of the exploration and construction of production networks throughout Southeast Asia. And from the late 1970s, Korea's big leap into the regional production network building followed suit. Now, China is in the forefront of intra- and extra-regional

trade networks. Since China's engines for economic reform were started up, it was presented with several opportunities throughout the past three decades: the combination of economic opening and domestic economic reform in China from the 1980s, coupled with the accommodation of the opportunities created by East Asian economic restructuring and foreign investment in the 1990s, and normalized trade relations with the United States and the entering into the world economy via accession to the WTO in 2001.¹ While China's potential for finance and services has yet to be realized, it has indeed succeeded in low-cost manufacturing and expansion of trade networks in the past decade, with high economic growth rates second to none in the global economy, albeit at the cost of unavoidable high inflation.

It is also apparent that China's economic rise has provided an opportunity for China to gradually restructure power politics in East Asia. Cautionary warnings for its trading partners are sent out regionally and globally. At the regional level, the intensified triangular relationship among the United States, Japan, and China manifests itself in current East Asian political and economic affairs. Its East Asian neighbors have already become very weary of China's speed of growth. At the global level, in addition to the debate on global imbalances and pressures for the appreciation of the renminbi from the United States and the European Union, developing economies, particularly those in Southeast Asia and Latin America, continuously raise concerns about losing ground to China in global market shares.²

Nevertheless, the upsurge of China's economic power and the CCP's adjustment to market capitalization have brought about challenges and frictions in trade at home and abroad. Three decades after the economic reform had been launched, China's quest for continued growth has inevitably widened the income disparity gap, and brought about political demonstrations and an outcry from its trading partners around the world in response to China's reshaping of the global economy.

In an effort to identify where China stands in the quest for regional free trade in East Asia, this chapter intends to focus on China's initiatives and dilemmas regarding regional free trade in East Asia. In response to the changing dynamics of East Asian regionalism, this research aims to provide the linkage between China's interests in trade for domestic growth. Through examinations of China's trade deals that are bargaining for interests catered to its economic development, it finds that China's objectives of economic growth and its control of finance and investment are embedded in its initiatives for regional free trade. It also finds that China continues to expand this capability via foreign economic policy: via proliferation of the Chinese economic development model to other developing countries of Southeast Asia, massive investment in the economies of ASEAN member states, and rapprochement with its East Asian neighbors to secure factors of production and markets for export. Finally, the research also sheds light upon the current dilemmas of China's pursuit of economic regionalization that may not be resolved simply by increasing the number of EPAs and/or FTAs.

CHINA'S INITIATIVES IN TRADE POLICY: GOING BILATERAL AND TRILATERAL

Prevailing Bilateral and Trilateral Economic Interests

From a macroeconomic perspective, China's comparative advantage in factors of production renders it a complementary economy for the developed economies—i.e., the United States, Japan, and the EU—but poses a considerable threat for competition for emerging market economies (EMEs). As developed economies become strongly reliant on China's low-cost goods, the impact of the Chinese economy on theirs is no longer complementary but has become the source of domestic political debates on the loss of manufacturing jobs and trade imbalance. This is all the more the case at the regional level in East Asia, in which the United States has played a significant political role since World War II and a Sino-U.S. rivalry is conceivable in proposed regional trade cooperation schemes as the Chinese economy continues to rise.

China has pushed for stronger ties with its Southeast Asian trading partners, the economies of whom Japan has continued to build firm production networks with in pursuit of its own economic development. Politically, Japan still holds open the door for the United States to continue to play a crucial role in the region, while protecting its economic gains by maintaining a sound relationship in trade and investment with China. This trend has become more apparent in Japan's foreign economic policy making in recent years. Regarding security dynamics that may impact economic interests in the region, the Asia-Pacific military allies of the United States—Japan, South Korea, Australia, Singapore, Thailand, and the Philippines—continue to rely on their alliances with the United States for security back-up and stability. At the same time, however, their economic interests are also closely attached to China, as trade volumes with China have increased considerably during the past decade.

The bilateral interests of neighboring economies compel China to pursue likewise. For Japan and South Korea, the dependence on the China market for their exports of high-tech goods and imports of low-cost materials has become an unavoidable, albeit rational, choice regardless of their preferences in trade tactics. Furthermore, running trade surpluses with China has motivated them to seek further opportunities in the China market—such as the initiatives for a South Korea–China FTA, a Japan–China EPA, and/or a trilateral China–Japan–Korea FTA and investment treaty. The most recent achievement is the Trilateral Investment Treaty reached by China, Japan, and Korea in April 2012. It is the first economic treaty concluded by the three economies, which includes a provision stipulating that a phased investment made before the establishment of a corporation is not subject to the anti-discrimination provision designed to protect foreign investors, while a phased investment after a corporation's establishment is subject to the provision.

The trilateral treaty also includes the Investor-State Dispute Settlement provision, which allows investors covered by the provision to initiate dispute settlement

proceedings against foreign governments in their own right under international law, as do China's bilateral investment treaties with Japan and Korea. The treaty is also expected to enhance investor rights in that it emphasizes the transparency of investment systems and protection of intellectual property rights and prohibits requirements for the transfer of technology belonging to foreign-invested companies. It is also anticipated that the signing of the China-Japan-Korea trilateral investment treaty will give boost to the possibility of a free trade agreement amongst the three economies in the longer future. Nevertheless, considering public opinions and domestic political dynamics in the three countries, regional initiatives for a trilateral trade agreement among the three countries would most likely be a long-term project.

Free Trade Agreements (FTA) and Economic Partnership Agreements (EPA)

In addition to the bilateral schemes that Japan and South Korea had been pursuing, China has also pursued extra-regional trade alternatives via trade agreements with the EU and India. The recent commitment that ASEAN countries have made through economic partnership agreements with China imply that U.S. economic influence in the region could decline significantly, in the midst of the weakening of the dollar and the increasing importance of the renminbi for transactions in the aftermath of economic recovery from the Global Financial Crisis. It is important to note that these new trade deals are pedestals for China's development strategies, in order to secure markets, energy, and resources from its Asian neighbors.

An additional source of pressure that adds to the prevalence of bilateral trade agreements is the relative stalemate in multilateral trade negotiations. Given the constraints in the current multilateral trade regime, China has been very active in pursuing bilateral free trade agreements outside the WTO framework. Within the past decade, it has succeeded in launching FTAs and EPAs with countries within the East Asian region and elsewhere. In principle, an FTA (Free Trade Agreement) is a legally binding agreement between two or more countries that allow the parties of the agreement to reduce or eliminate barriers to trade, and to facilitate the cross-border movement of goods and services between the territories of the parties. Technically, FTAs are in fact a part of (comprehensive) Economic Partnership Agreements (EPA), which were initiated by countries such as Japan and Korea in the turn of the century. The differences between FTAs and EPAs are in that EPAs are not necessarily limited to trade and investment, but also encompasses agreements on other components of the economy—that is, tourism, the standardization of regulations for businesses, and intellectual property, among many other sectors.³ Accordingly, EPAs cover a wider range of economic relations than FTAs, but are also preferential in that parties to the agreement may choose to open certain sectors of the economy and keep other sectors protected. As for China, establishing FTAs within the region is a preliminary step in building economic trade networks in East Asia.

Table 7.1. China's Participation in Bilateral and Regional Trade Agreement (May 2012 Present)

<i>China's Free Trade Agreements</i>	
China-ASEAN FTA (ACFTA)—includes the Philippines, Malaysia, Myanmar, Thailand, Brunei, Singapore, and Indonesia	Signed in November 2004
China-Pakistan FTA	Signed in November 2006
China-Chile FTA	Signed in 2005
China-New Zealand FTA	Signed in April 2008
China-Singapore FTA	Signed in October 2008
China-Peru FTA	Signed in April 2009
Mainland and Hong Kong Closer Economic and Partnership Arrangement	Signed in June 2003
Mainland and Macau Closer Economic and Partnership Arrangement	Signed in October 2004
China-Costa Rica FTA	Signed in November 2008
<i>China's Free Trade Agreements under Negotiation</i>	
China-GCC (Gulf Cooperation Council) FTA	Negotiations launched in July 2004
China-Australia FTA	Negotiations launched in October 2006
China-Iceland FTA	Negotiations launched in April 2007
China-Norway FTA	Negotiations launched in September 2008
China-SACU(Southern African Customs Union) FTA	Negotiations launched in June 2004
<i>China's Free Trade Agreements under Consideration</i>	
China-India Regional Trade Arrangement (RTA) Joint Feasibility Study	Study Group established in 2003
China-Korea FTA Joint Feasibility Study	Study Group established in November 2004
China-Japan-Korea Trilateral FTA Joint Study	Study Group established in August 2010
China-Switzerland FTA Joint Study	Study Group established in September 2010
<i>China's Preferential Trade Agreement</i>	
Asia-Pacific Trade Agreement (The Bangkok Agreement)	Signed in 1975

Source: Ministry of Commerce, the People's Republic of China (May 2012)

China's Trade Deals in East Asia

China has worked extensively on expanding its trade network not just in the East Asian region and the Asia-Pacific region, but also around the world. Its free trade agreement with Pakistan shows that China has reached out with a strong political appeal. It is a contrast from the stagnant procedures of the China-India Regional Trade

Agreement (RTA) Joint Feasibility Study Group which has prolonged the process since 2003, and this backwardness can be assessed as China's balancing on India as a potential, emerging rival economy of South Asia. Recent developments have shown India's reluctance toward signing of the RTA, notably owing to India's current trade imbalances with China, and continuous Indian requests to lower China's non-tariff barriers (NTB) to facilitate the increased movement of goods over the border. More importantly, political and security risk concerning India have influenced China's attitude regarding India's expanding role at the regional and international level. The proposal for the China-India RTA has been put on the back burner as the bilateral relationship has become tense.

Meanwhile, FTAs with Chile, Peru, and Costa Rica show that it is determined to actively engage with the Latin America and the Caribbean (LAC) region.⁴ The China-Peru FTA was the first comprehensive FTA that China had signed with a Latin American economy. Amongst all LAC countries, Chile has been the most open to FTAs—it was the first FTA partner for South Korea in 2002 and an FTA with Japan followed suit in 2006. Chile's 2005 FTA with China extended zero duty treatment phase by phase to cover 97 percent of products over a span of ten years. China has also been closely engaged with signing FTAs with economies of the Asia-Pacific, specifically in the Oceanic region. Its FTA with New Zealand was the first that China had ever signed with a developed economy, and FTA negotiations with Australia have been ongoing since 2005—Australia has also engaged in FTA negotiations with Japan since 2007.

China's current negotiations underway for FTAs outside the region include those with the Gulf Cooperation Council (GCC: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates) which started in 2004; negotiations with the Southern Africa Customs Union (SACU: South Africa, Botswana, Namibia, Lesotho, and Swaziland) which also started in 2004; and negotiations with Northern European economies such as Iceland and Norway. Also, a study group for an FTA with Switzerland is ongoing since 2010—Switzerland already signed an EPA with Japan in 2009. Iceland was the first developed European country to recognize China as a full market economy and the first European country to negotiate an FTA with China. A potential FTA with Norway is also pivotal in that it is one of China's main suppliers of fertilizers, aquatic products, and oil, with negotiations having been launched in 2008. While China's penetration into the economies of the Arab region and the African region are not a surprise given that these regions are abundant in natural resources, it is also not a surprise that China has yet to begin FTAs with MERCOSUR and the European Union, since the economies of these regions have mixed effects from Chinese imports.

China's most extensive regional FTA is the China-ASEAN FTA, which has evolved over a span of nearly a decade. China and the ASEAN Member States (AMS) first signed the Framework Agreement on China-ASEAN Comprehensive Economic Cooperation at the Sixth China-ASEAN Summit in November 2002. In November 2004, Chinese Premier Wen Jiabao and the leaders of AMS witnessed the signing of the Agreement on Trade in Goods of the China-ASEAN FTA, which entered into

force in July 2005. In January 2007, the two parties signed the Agreement on Trade in Services, which entered into effect in July 2007. In August 2009, the two parties signed the Agreement on Investment. The establishment of China-ASEAN Free Trade Area was intended to enhance the close economic and trade relations between the two parties, and also to contribute to the economic development of Asia and the world at large. What appears to have been essential for China in launching the China-ASEAN FTA, is gaining further access to its geographically closest neighboring nations that are still in earlier phases of economic development, and establishing stable political relations through the process. In recent years, China's regional initiatives in Southeast Asia have been reflected in its gradual increase of FDI net inflows into ASEAN member state economies.

The most critical and recent development in China-ASEAN economic relations is the transactions held in renminbi (RMB). Since the ASEAN-China Free Trade Area came into force in January 2010, Thailand and the ASEAN have increasingly requested RMB denominated transactions and trade settlements. The direct settlement of renminbi and respective local currencies of ASEAN economies has become possible via agreements by the Bank of China Hong Kong, the Bank Central Asia—Bangkok branch of the Bank of China, Manila Branch of the Bank of China, Jakarta Branch of the Bank of China, Singapore branch of the Bank of China, Malaysian branch of the Bank of China, which will become participating banks of RMB business in the ASEAN region. The clearing and settlement agreement of RMB-denominated trade transactions is a big leap toward making the Chinese yuan one of the world's top currencies, allowing Chinese exporters and importers to start settling trade in RMB rather than dollars.

Among the ASEAN member states, Singapore is the most open economy in trade with a positive stance toward FTAs. Since the signing of Singapore's first FTA under the ASEAN Free Trade Area (AFTA) in 1993, Singapore's network of FTAs has expanded to cover eighteen regional and bilateral FTAs with twenty-four trading partners—given its restraints in resources but advantages in geographical location, it is by far one of the most FTA-driven economies of the world. It was the first test option for an FTA for Japan (New-Age Economic Partnership Agreement: JSEPA) in 2002, and it was the one ASEAN state to sign a bilateral FTA with China in 2008. Although physically small in size, Singapore's per capita income, living standards, and strategic priorities resemble those of Japan. For China, Singapore's growing diplomatic profile in the Southeast Asian region was also enticing, as its influence with other ASEAN member states cannot be underestimated. The absence of a major agricultural sector in Singapore was also an important factor for the highly protected agricultural markets in the Japanese economy, if not for China.

China's EPAs with Hong Kong and Macao were crucial in building political and economic partnerships with these two areas. These EPAs were signed between the Chinese Central Government and the Special Administrative Region of Hong Kong in 2002, and also between China and the Special Administrative Region of Macao in 2003, which are separate customs territories. To note, these were the first FTAs

to be fully implemented in the Chinese mainland. Given the political importance of these regions for China, these two agreements were a necessary foundation for the application of the “One Country, Two Systems” principle, for institutional cooperation between the mainland and the two SARs. Since the turnover of Hong Kong in 1997, it was a necessary and advantageous step for China to embrace the Hong Kong economy, as China’s economic transformation from the 1980s owed much to the prepared legal institutions based in Hong Kong, which enabled mainland enterprises to start operations.

The most anticipated but elongated FTA in the region for China is the China-Japan-Korea Trilateral Free Trade Agreement. At the current stage, it is still in the status in which an established Joint Study and Research Committee status is holding meetings, with the first meeting launched in August 2010. The negotiations are prolonged in part due to Korea’s willingness to negotiate a China-Korea FTA beforehand, but more because of Japan’s careful approach toward a trilateral free trade agreement or any FTA—Japan’s FTA negotiations with Korea had been stalled since 2003 and an FTA with China is an option that Japan should dwell upon when the Trans-Pacific Partnership (TPP) negotiations under the lead of the United States are ongoing. Korea, which has been strongly driven by FTA and EPA agendas in the past few years, has continuously showed keen interest in an FTA with China. The unofficial joint study group for a China-Korea FTA was launched in 2004 and the group was upgraded to a joint official study group with the participation of government officials, businessmen, and academics, although difficult issues remain that may halt the launch of negotiations. However, just as in the course of KOR-US FTA negotiations, the incumbents of the Korean government must risk losing votes from upset farmers, fishermen, and small-and-medium-sized manufacturing companies in the event of a China-Korea FTA.

TRADE AGREEMENTS OF CHINA’S NEIGHBORING STATES IN THE REGION: COMPARATIVE PERSPECTIVES

Japan’s Comprehensive Economic Partnership Agreements (CEPA)

As Japan’s dependency ratio on trade with other economies as a percent of GDP (approximately 40 percent, 2012 percent) is far lower than China’s (60 percent, 2012 present) and Korea’s (approximately 85 percent, 2012 present), Japan has taken a relatively careful and gradual approach in terms of signing economic partnership agreements. Japan has maintained a highly protected agricultural market whilst opening manufacturing and high-tech industries to the world for parts and whole products. For a country like Japan that retains a large, self-sustaining domestic market and a slow and rigid decision-making process in which the Japanese bureaucracy primarily depends on precedence, opting for trade was the least

favorable choice for Japan. However, changing trade dynamics with neighboring economies China and Korea and potential market losses have stirred debates on the Japanese government's unhurried approach in adding new EPAs to its agenda. The Japanese government therefore has taken very cautious steps toward EPAs—a noticeable characteristic of Japan's trade policy is reflected in the choice of wording "EPA" rather than using the term "FTA" in their agreements. Labeling most of the trade agreements as EPA instead of FTA lessens political burdens on the incumbent parties and ministries by not directly engaging the Japanese public's negative stance regarding trade.

Japan's EPA negotiations are prepared and conducted simultaneously by relevant ministries in the Japanese government: the Ministry of Foreign Affairs (MOFA), the Ministry of Finance (MOF), the Ministry of Agriculture, Forestry and Fisheries (MAFF), and the Ministry of Economy, Trade and Industry (METI). While the MOFA takes the initiative for scheduling and conducting the negotiations, other industries strive to see the potential benefits and losses of future EPAs through careful examinations and simulative discussions. Economic research institutions such as the Japan External Trade Organization (JETRO) and the Japan Chamber of Commerce and Industry (JCCI) also generate ideas on the future prospects of potential EPAs and assessments on current EPAs.

While Japan and China both exhibit their interests in regional trade with Southeast Asian economies, Japan's recent hurdles in regional trade are reflected in the ongoing negotiations for an EPA with Australia. Since the launch of negotiations in April 2007, the negotiations have been prolonged considerably due to unmet interests. An economic partnership with Australia and New Zealand also opens doors for Japan to join the Trans-Pacific Partnership Agreement, but coming to terms with strong agricultural producers such as Australia and New Zealand requires opening the agricultural market for Japan. The main causes of the stalemate process in Japan-Korea EPA negotiations are centered around the same reason—Japan's reluctance to agricultural market opening. Meanwhile, both Japan and Korea have managed to sign EPAs with an emerging economy that China has yet to sign an FTA with—India.

Korea's FTAs and EPAs

Korea is by far the most active country among the three Northeast Asian economies in terms of conducting FTA and EPA negotiations. Korea's free trade negotiations are conducted in a similar fashion to Japan's, with the Ministry of Foreign Affairs and Trade at the lead and relevant bureaus at the Korean Customs, the Ministry of Strategy and Finance (MOSF), the Ministry of Agriculture and Forestry (MAF), the Ministry of Culture, Sports, and Tourism (MCST). Final decisions for the signing of FTAs are also conducted at the presidential level and in the Korean National Assembly. Additionally, the Korea International Trade Association (KITA) and the Korea Institute for International Economic Policy (KIEP) conduct research on the potential benefits and losses of FTAs.

Table 7.2. Japan's Participation in Bilateral and Regional Trade Agreements (May 2012 Present)

<i>Japan's Economic Partnership Agreements</i>	
Japan-Singapore EPA	Signed in March 2007
Japan-Mexico EPA	Signed in September 2004
Japan-Malaysia EPA	Signed in December 2005
Japan-Chile EPA	Signed in February 2006
Japan-Thailand EPA	Signed in April 2007
Japan-Indonesia EPA	Signed in August 2007
Japan-Brunei EPA	Signed in June 2007
Japan-ASEAN EPA	EPAs signed with Singapore, Laos, Vietnam, Myanmar, Brunei, Malaysia, Thailand, Cambodia by July 2010. Indonesia is the only signatory of the EPA remaining to go into effect.
Japan-Philippines EPA	Signed in September 2006
Japan-Switzerland EPA	Signed in February 2009
Japan-Vietnam EPA	Signed in December 2008
Japan-India EPA	Signed in February 2011
Japan-Peru EPA	Signed in May 2012
<i>Japan's Free Trade Agreements under Negotiation</i>	
Japan-Korea EPA	Negotiations stalled since November 2004. Japan-Korea high-level meetings to restart negotiations have begun since May 2010; the second bilateral was held in May 2011.
Japan-GCC EPA (includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE)	Negotiations have begun since September 2006
Japan-Australia EPA	Negotiations have begun since April 2007

Source: Recompiled from "EPA/FTA Negotiations and Status," Ministry of Agriculture, Forestry and Fisheries, Japan, May 2012.

Korea's trade agreements are not necessarily labeled as "EPAs," with the CEPA with India being an exceptional case. Nevertheless, the processes of opening up additional sectors of the economy undoubtedly stirs political controversies, and strong public opinion regarding trade agreements is often times manifested in massive on-street demonstrations. Despite the political difficulties, the Korean Ministry of Foreign Affairs and Trade has spearheaded trade negotiations with a strategic approach—gaining markets ahead due to its high dependency-ratio on external trade, and simultaneously expanding free trade networks with multiple countries in a steadfast manner. In this respect, expanding free trade networks outside the WTO is an inevitable choice for Korea due to its heavy reliance on external trade. Currently, Korea lacks the room for policy space to improve the import-export structure.

Currently, Korea's FTAs with Chile, Singapore, EFTA, ASEAN, the European Union, Peru, and the United States and an EPA with India are in effect. Another

Table 7.3. Korea's Participation in Bilateral and Regional Trade Agreements (May 2012 Present)

<i>Korea's Free Trade Agreements</i>	
Korea-U.S. FTA	In effect since March 2012
Korea-Peru FTA	In effect since August 2011
Korea-EU FTA	In effect since October 2011
Korea-India CEPA	In effect since January 2010
Korea-ASEAN FTA	In effect with all ASEAN states
Korea-EFTA (European Free Trade Area: includes Switzerland, Norway, Iceland, Lichtenstein) FTA	In effect since September 2006
Korea-Singapore FTA	In effect since March 2006
Korea-Chile FTA	In effect since April 2004
Korea-Turkey FTA	Negotiations completed in March 2012
<i>Korea's Free Trade Agreements under Negotiation</i>	
Korea-Canada FTA	Under negotiations since May 2004
Korea-Mexico FTA	Under negotiations since May 2000
Korea-GCC FTA	Under negotiations since March 2007
Korea-Australia FTA	Under negotiations since December 2006
Korea-New Zealand FTA	Under negotiations since December 2006
Korea-Columbia FTA	Under negotiations since July 2008
Korea-Indonesia FTA	Under negotiations since May 2011
Korea-China FTA	Under negotiations since September 2004
<i>Korea's Free Trade Agreements under Consideration</i>	
Korea-Japan FTA	Under joint study since November 1998
Korea-China-Japan Trilateral FTA	Under joint study since 2003
Korea-MERCOSUR TA	Under joint study since 2005
Korea-Russia BEPA	Under joint study since 2007
Korea-Israel FTA	Under joint study since 2009
Korea-SACU FTA	Under joint study since 2009
Korea-Vietnam FTA	Under joint study since 2010
Korea-Mongolia FTA	Under joint study since 2008
Korea-Central America FTA	Under joint study since 2010
Korea-Malaysia FTA	Under joint study since 2011

Source: Recompiled from the FTA Portal, the Ministry of Foreign Affairs and Trade, Korea, May 2012.

FTA was signed with Turkey, which will soon come into effect within this year. Negotiations for trade agreements are currently ongoing with Canada, Mexico, the Gulf Cooperation Council, Australia, New Zealand, and Columbia. Korea's joint-study groups for FTAs are being conducted with China and Japan for a trilateral FTA and respective bilateral FTAs; MERCOSUR, Russia, Indonesia, Malaysia, Central America, Mongol, Vietnam, SACU, and Israel are also participating in joint-study groups for FTAs with Korea. After completing years of trade negotiations and renegotiations for the EU-KOR FTA and KOR-US FTA, an FTA with China had been a

top priority agenda for Korea in terms of securing large markets, and its negotiation is likely to be launched in the immediate future.

DILEMMAS OF CHINA'S INITIATIVES IN ECONOMIC REGIONALIZATION

Frictions in Trade Disputes at the Multilateral Level and Responses from Trading Partners

One of the most debatable issues in policy agenda following the Global Financial Crisis was the discussion on global imbalances. Since the recovery from the Asian Financial Crisis and particularly from about 2005, there have been growing concerns on the issue of global imbalances, with a focus on trade imbalance between the United States and China. The increasing amount of U.S.-China trade imbalances had been the grounds for the Obama administration's continued pressures on China for renminbi appreciation. For the United States, the exchange rate pressures on China are in effect a preventive measure to avoid the U.S. being placed at a huge comparative disadvantage in trade with export-oriented trading partners.

Trade frictions at the government level through the WTO and private lawsuits by industries will continue as long as there is a losing ground for the United States to do business in China and a domestic pursuit of incentives and interests through lobbying that will foster industries in the United States (Refer to the list of China's WTO dispute settlement cases as complainant and respondent in the appendix section.) Similar policies with diplomatic pressures at a different angle have been placed on Japan and Korea's automobile industries, that is, in the hearings on Toyota Congressional Hearing in 2010 and the renegotiation process of the KOR-US FTA. The mounting trade imbalances with its Northeast Asian trading partners in the past decades remains unresolved, and the United States still seeks to remain engaged in the region to avoid being "decoupled" from the East Asian regional policy-making process. Looking back on the past exchange rate debates and pressures regarding the Japanese yen and the Korean won in the 1970s–1980s, the U.S. claims on China's manipulation of its currency is highly likely to be repeated over time in the course of future U.S.-China trade relations. Though the yuan has been appreciated slightly following the currency debate in the G20 in 2009, China's fixed exchange rate pegged to the U.S. dollar will remain for the time being, and political confrontations over monetary policy are here to stay.

China's economic growth has now become a prominent issue for U.S.-China bilateral relations as well as for countries closely linked with China in the region. Despite the U.S. interests in maintaining a stable relationship with China and Japan to retain its influence in Asia, the relative gains of China in the region are compelling the United States and neighboring nations to engage in competitive bilateral relations. This in turn creates a constant power game and instability in the region. The intra-regional competition dynamics can be summarized as the "U.S.-China-Japan Triangle" and is quite straightforward: while Japan's economic stagnation has been

China, P.R. Yuan (H10/H10RXI_NA.CH)

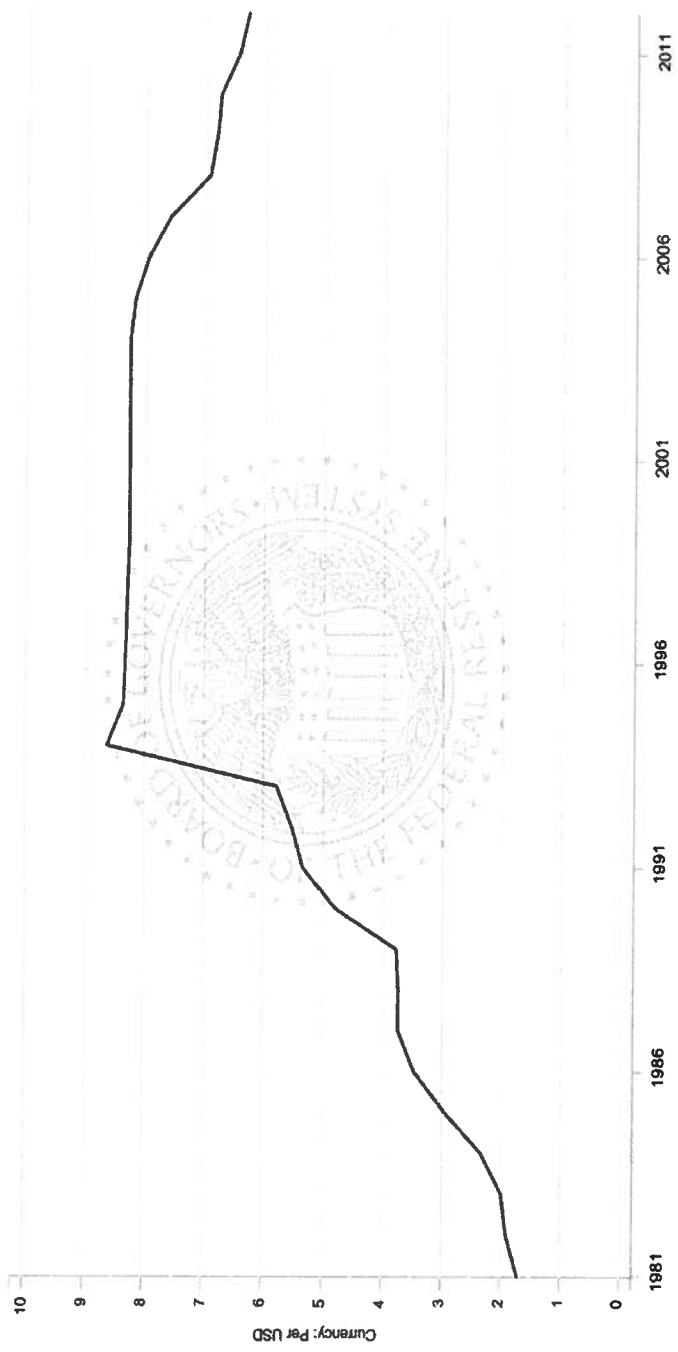


Figure 7.1. Exchange Rate Volatility RMB against the USD (1975–2010)
Source: Federal Reserve Board 2012.

reflected in its limited ability to exert influence abroad for the past two decades, China's economy has been enjoying a 7–12 percent GDP growth rate per year owing to a large-scale domestic investment and massive influx of foreign direct investment. From outside the region, the United States currently faces trade imbalances with all three Northeast Asian states, the largest of which is with China.

Currently, the U.S.-China trade imbalance stems from the growing U.S. consumption of Chinese manufactured goods and Chinese acquisitions of U.S. assets, particularly in the form of U.S. treasury bonds. The figures indicate that Mainland China took over Japan as the top foreign holder of U.S. treasury securities since 2008. The more China seeks to engage in deeper economic relations with its regional neighbors of East Asia, the more intense the U.S.-China regional competition for leadership can get. With Japan holding the door open for continued U.S. engagement in the region to balance against China, the U.S.-China-Japan Triangle creates a difficult dynamic in building regional leadership regarding economic policy making and prolongs the preference for bilateralism over multilateralism or regionalism in the region.

Regional Financial Cooperation and Renminbi Internationalization

Before the Asian Financial Crisis (AFC) of 1997, an “organizational gap” prevailed in Northeast Asia due to the absence of a power balance and different state structures.⁶ While it was widely understood that Northeast Asia featured the paradox of growing economic integration and stagnant political cooperation, the AFC was a turning point for regional institution building in the region. The Asian Financial Crisis inevitably gave awareness to East Asian countries of the need to promote regional financial cooperation to prevent further crises and to retain stable economic growth. Northeast Asia remains a region that demonstrates relatively slow formal and legal integration, due to income disparities and differences in business cycles amongst economies.

With regard to regional financial cooperation, the major economies of Japan, China, and Korea acknowledged the need for a regional framework in the aftermath of the 1997 financial crisis, and implemented a common regional bond market, the Asian Bond Market Initiative (ABMI), and the Chiang Mai Initiative (CMI), a network of currency swap agreements among ASEAN+3 countries to secure liquidity against future financial crises. In the course of the global financial crisis, the CMI has evolved into a regional fund under the Chiang Mai Initiative Multilateralization (CMIM), with the proportions of the contributions to the fund decided upon diplomatic negotiations (China: Japan: Korea = 2:2:1, the remaining 2~ percent of the fund contributions from ASEAN). In the course of the negotiations, China has created a level-playing field with Japan in the regional financial cooperation framework. While this is a good start for regional financial cooperation, the use of the fund is still partially subject to IMF conditions and has never been put into practice under actual circumstances of financial emergency. So far, neither China nor Japan has

demonstrated willingness to lead the charge to make substantial progress to develop this institution into a full-fledged cooperative mechanism in regional finance. Very recently, the CMIM pool of funds was doubled to \$240 billion by unanimous agreement of CMIM member states. China and Japan have always vied for leadership in the regional financial cooperation mechanisms, as Japan had previously pursued an Asia Monetary Fund (AMF) proposal, only to be turned down by the United States in 1999 following the Asian Financial Crisis.

Another development in East Asian regional financial cooperation is the establishment of the Credit Guarantee Investment Facility (CGIF) capitalized at \$700 million. The launch of the CGIF was decided at the 13th ASEAN Finance Ministers Meeting, in which the ministers of ASEAN+3 agreed to establish ASEAN+3 macroeconomic research office (AMRO) based in Singapore, which was incorporated in April 2011 as a company limited by guarantee under the Companies Act, Cap. 50, of the Republic of Singapore as ASEAN+3 Macroeconomic Research Office Limited (AMRO Limited). It is currently composed of four members—finance ministries of China, Japan, Korea, and Singapore—and led by a Chinese director, Mr. Wei Benhua, who is to be succeeded by a Japanese head in the coming years.⁷ The CGIF has the objectives for corporations to issue bonds in their domestic markets as well as in neighboring markets and across the ASEAN+3 countries. Again equal shares for investment was provided for China and Japan. The CGIF will be governed by an eight-member board drawn from contributing countries, including one representative from the Asian Development Bank (ADB), of which the Japanese government is a main sponsor. Once the \$700 million capital has been used up, the board will review the CGIF's role, organizational structure and operations to decide whether the capital or 1:1 leverage ratio should be increased.

Regional Leadership and Economic Rivalry with the United States—TPP

The U.S. balance against China's economic outstretch in the China-oriented trade agreement in the ASEAN+3 framework in the East Asian region is reflected in the Obama administration's change of gears and the drive for the Trans-Pacific Partnership (TPP) or the Trans Pacific Strategic Economic Partnership Agreement. The TPP aims to abolish tariffs completely, without exceptions. Originally a framework comprising Brunei, Chile, New Zealand, and Singapore, the TPP has expanded to include the United States, Australia, Peru, Vietnam, and Malaysia. So far, four formal rounds of TPP negotiations have been held since 2010, led by the United States and Australia. In the beginning phase, it was difficult to judge the U.S. level of intensity and interest in the TPP agenda, just after the inauguration of President Barack Obama in January 2009, as the anticipated March 2009 negotiations were postponed. However, President Obama's first trip to Asia in November 2009 reaffirmed the U.S. commitment to the TPP, and the United States is currently leading the negotiations with the objective of shaping a high-standard, broad-based regional pact. China has expressed its interest in joining the TPP, although it is unclear how

serious China is about joining. Japan is still in the course of deciding whether it should join the talks or not, and Korea has been requested to join by the United States following the KOR-US FTA renegotiations.

CONCLUSIONS: THE TWO-DIMENSIONS OF CHINA'S TRADE BARGAINING

Will China's rise and intent for economic regionalization be a catalyst or a hindrance for East Asian institutionalization? At this stage, there is no definite answer to this question; nevertheless, there is truth to interpreting China's initiative and drive for economic regionalization in East Asia. What really matters from this point forward is the response from the neighbors: at a stage in which China's rise is perceived both as a threat and an opportunity, how much validity in China's economic outreach are they willing to take in? Whether China will transform into a responsible actor and leader in the global political economy and also in the East Asian regional economic cooperation remains to be seen, and China faces the tasks of having to meet expectations in the areas of international trade practices and implementations of international standards and regulations in the domestic economy as well as in its external trade relations. Strictly speaking, however FTAs and EPAs are signed and implemented outside the WTO framework, the significance of regular trade practices are what constitutes the basis and outcome of reciprocal expectations of bilateral parties in free trade and economic partnership negotiations. In this respect, the cases of WTO dispute settlement cases reflect the deficiencies of China's practices in trade and services (i.e., sanitary and phytosanitary measures, intellectual property, financial opening) that have yet to be met with international standards. It is also all the more difficult to impose a certain standard on an economy that is dual-positioning itself as (1) a developing economy that is rent-seeking and also aims at exclusive treatment from international standards practiced by trading partners, and (2) a growing economy holder of strong purchasing power in the global economy that also retains the ambitions of a regional leader. The transitional period in between these positions may take longer for the case of China than it did for Japan and Korea, as China has not yet been met with a critical juncture that shook its economic fundamentals entirely, whereas Japan had gone through a currency readjustment via the Plaza Accord in 1985, the burst of the bubble economy at the end of the 1980s, and a major financial reform during the Big Bang in 1996; Korea had a nationwide structural reform in finance and trade under the IMF guidelines in recovering from the Asian Financial Crisis.

Two decades past the economic reform launched in 1989, China is throwing itself into a power game in a region in which the history of bilateral trade relations and development of the financial markets in East Asia reveals the significance of the role of the United States. Accordingly, as China progresses its regional outstretch, a confrontation with the United States in economic policy making at both global and regional levels is

unavoidable. In the meantime, Northeast Asian states' increasing involvement in cross-regional or bilateral trade agreements and partnerships elsewhere (i.e., the European Union, India) demonstrates an ongoing struggle among East Asian states based on the principle of self-help. Inevitably, the East Asian regional economic integration process has been and will continue to be heavily skewed by strong bilateral relations, extra-regional pressures, and intra-regional self-help seeking behavior for national interests of states. China's pursuit of regional leverage will continue to serve as a diplomatic tool for economic regionalization in East Asia, in the midst of intra- and extra-regional competition in the years to come.

NOTES

1. Naughton, B., *The Chinese Economy* (MIT Press, 2007).
2. Gallagher, K., and Roberto Porzecanski, *The Dragon in the Room: China and the Future of Latin American Industrialization*. (Stanford, CA, Stanford University Press, 2010).
3. Press briefings by press secretary of the Ministry of Foreign Affairs (MOFA) of Japan, Hatsuhsa Takashima (December 11, 2003). For instance, Japan's FTA and EPA strategies have been highly selective, in order to maintain political burdens of having to open its agricultural markets very low in the event of a free trade or economic partnership agreement.
4. While China is regarded as both an opportunity and a threat to many Latin American export economies such as Mexico, Brazil, Chile, and Argentina, the most vulnerable economy under China's influence is Mexico. Contest with China's economy is all the more difficult for the Mexican economy, its manufacturing sectors having been already distraught under the NAFTA (North American Free Trade Agreement of 1994).
5. Calder, K. a. M. Y. (2004). "Regionalism and Critical Junctures: Explaining the 'Organization Gap' in Northeast Asia." *Journal of East Asian Studies* 4(2) 2004: 191–226.
6. AMRO Official Website (www.amro-asia.org).