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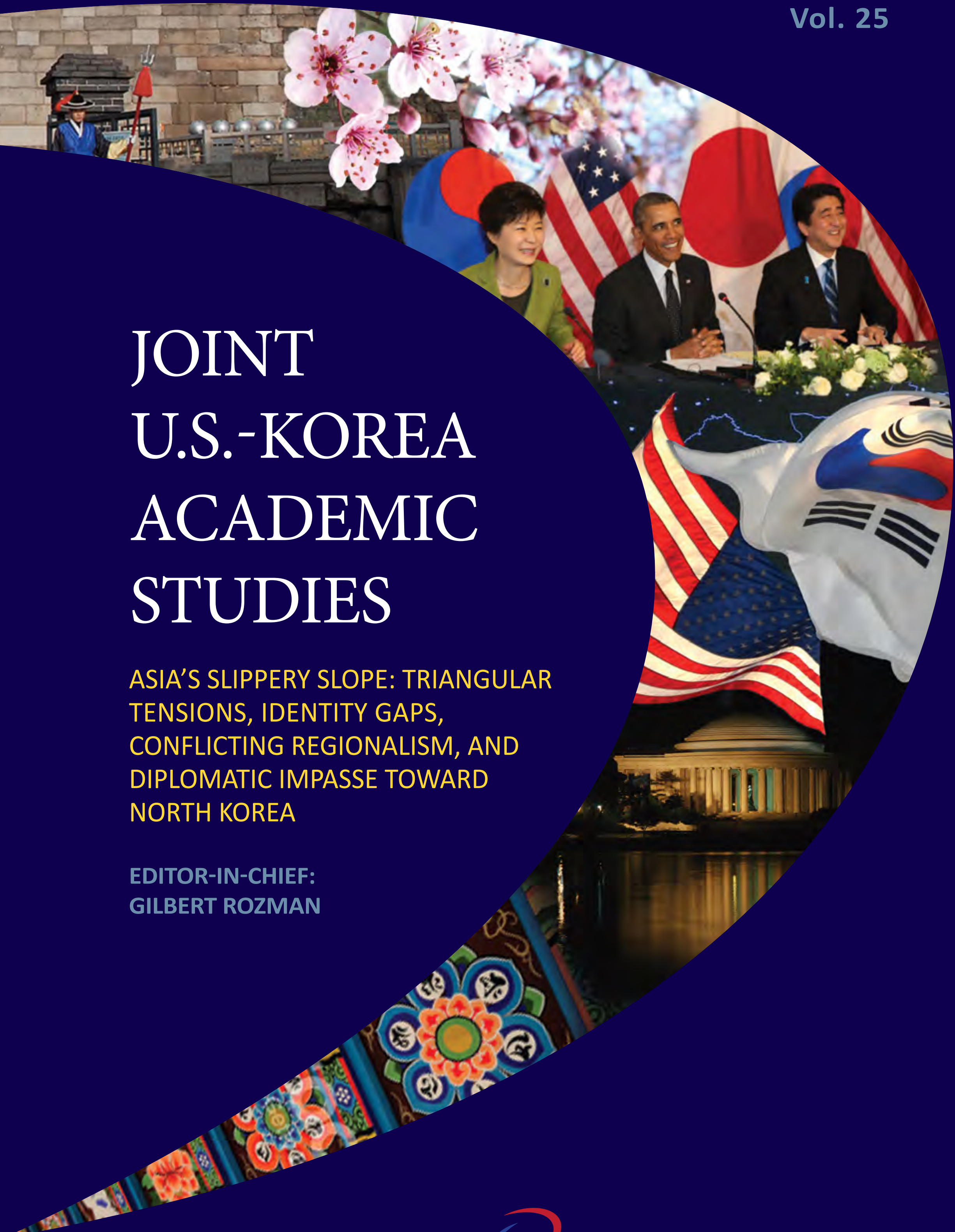

JOINT U.S.-KOREA ACADEMIC STUDIES

ASIA'S SLIPPERY SLOPE: TRIANGULAR TENSIONS, IDENTITY GAPS, CONFLICTING REGIONALISM, AND DIPLOMATIC IMPASSE TOWARD NORTH KOREA

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DIVERGENCE ON ECONOMIC REGIONALISM

China's Choice: To Lead or to Follow on Asian Economic Integration

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For many years, the major trading countries coexisted comfortably under a multilateral trading system. Major trade liberalizations were agreed upon multilaterally. In most cases, trade disputes were resolved peacefully under the WTO dispute settlement system. The industrialized economies even reached a gentlemen's agreement that no bilateral FTA should be reached among them at the expense of the multilateral route of trade liberalization. All this is about to end. Trading nations are now forging free trade alliances on their own, fragmenting the world trading system and making trade diversions prevalent. Every country is feeling less secure and going for more FTAs. This situation might give rise to a "warring states" scenario (as in ancient China), which could replace the "Congress of Vienna's system of international trade." China is now accelerating the pace of negotiating FTAs, in particular in Asia, largely in response to developments in the negotiations of the TPP, TTIP, and other regional initiatives for economic integration. This chapter discusses the internal and external contexts that China faces, its responses so far, and its possible future behavior, with a focus on the steps it is taking in Asian economic integration.

Context

We are probably now in a period of post-multilateralism, or of weak multilateralism. The Pax Americana, which was secured first by American hegemony and later by institutions such as GATT/WTO, is largely gone. The rise of BRICS and the relative decline of the United States and the EU, largely due to the global financial crisis and the Euro debt crisis, have changed the balance of power of the WTO system. The 2003 Cancun WTO Ministerial Conference started to witness the emergence of a new negotiating group consisting of India, Brazil, China, and other developing countries, at loggerheads with the developed economies. One negotiation after another failed, and one deadline after another was missed. The Doha Round was frequently in crisis. Fundamentally, the changed relationship in relative power between a large developing country group and the U.S.-EU-led developed economies has made the existing WTO negotiating mechanism and even the negotiating agenda anachronistic. The United States and the EU finally decided to withdraw from the multilateral negotiating table and move to the regional stage. The Asia-Pacific is obviously the ideal choice since it represents the most vibrant part of today's world economy.

For the United States, it is a strategic withdrawal from multilateralism, which is rooted in its traditional instrumentalism vis-à-vis multilateralism.[1] The U.S. strategic shift from multilateralism to bilateralism/regionalism was equally driven by its geostrategic interests. The Asia-Pacific region is equally important for economic and security objectives. As President Obama made clear, he is a Pacific president. For the EU, the shift is mainly driven by geo-economic interests, as the Asia-Pacific region is an essential part of the global supply chain for European companies.

The U.S. pivot to Asia, and the EU's "looking-East" have caught China by surprise. For a decade, it had been integrating with East Asia through two vehicles—the China-ASEAN FTA and the so-called "10+3" framework, namely ASEAN plus China, Japan, and South Korea. If we decide that the United States had to withdraw from the multilateral front due to the decline of its relative strength and its lack of capacity for providing global public goods, the United States still had sufficient strengths and intellectual leadership to launch an Asia-

Pacific "offensive," matched by the EU's looking-east strategy. Slowly, China has started to respond, but it remains indecisive, hesitating between multilateralism and bilateralism. It seems that China has yet to decide whether to fill the vacuum left by the U.S. strategic withdrawal from the multilateral frontier. In the Asia-Pacific region, China seems equally uncertain about which path it should take: 10+3, RCEP, APEC, or TPP. China might eventually use all of them, but it is still an open question which path should be prioritized given China's limited resources and capacity. The following three sections discuss the implications of TPP, TTIP, and EU-Japan FTAs for China, mainly from the perspective of economics.

The Implications of TPP for China

In many ways, China's Asia-Pacific strategy was a response to the overall context of the U.S. pivot towards Asia and the U.S. discovery of TPP as a geostrategic vehicle for reasserting its influence in the Asia-Pacific. Here, we focus our analysis on TPP's economic and rules-setting impact on China. First, the completion of TPP would have a significant negative impact on China's economy. Petri's study shows that the presence of the TPP would have reduced China's GDP by $1 billion in 2014, as much as $28 billion by 2020, and an even larger $47 billion by 2025, ultimately lowering China's GDP by roughly 0.3 percent. Such a negative impact mainly results from the trade diversion effects it causes. By 2025, those effects would lead to a loss of 1.2 percent of China's exports, equivalent to $57 billion.[2]

Second, TPP might have some positive effects on China since it is linked to China's new reform and opening-up agenda. The 3rd Plenary Session of the 18th Congress of the Chinese Communist Party laid out a reform blueprint, prioritizing the role of the market, calling for SOE reform, more competition, fewer monopolies, and equal treatment of SOEs and privately-owned enterprises. Labor rights, environmental standards, and intellectual property protection are equally put onto the reform agenda. Taking services and investment rules as an example, TPP adopts the pre-establishment national treatment and negative list approach, as China is now doing in the process of building the Shanghai Free Trade Zone and negotiating relatively ambitious bilateral investment treaties respectively with the United States and the EU. The government is now pushing through a new round of administrative regime reform, aimed at changing its role and further opening up China to the world.

Competition policy is another example showing the delicate link between the TPP and China's reform agenda. TPP advocates "competition neutrality," asking the host country to restrain its own SOEs, reducing market distortions due to the privileges of SOEs, and leveling the playing field. For many years, Chinese SOEs have been seen as "first among equals" in China's corporate world. It is predictably a challenge for China to reform its own SOE sector.

To summarize, TPP does potentially have trade diversion effects on China, as well as competition pressure on China for further adjustment, coinciding with its new reform and opening-up agenda. However, the interesting linkage between TPP's inductive role and China's reform needs will not be automatically translated into reform achievements. The domestic resistance, which Chinese reformers now face, is much stronger than in the early 1990s.

The Implications of TTIP for China

There are two types of implications of TTIP for China: 1) "trade diversion effects," which are mainly focused on the diversion of trade in goods; and 2) effects on rules.

Trade Diversion effects refer to trade that occurs between members of an FTA that replaces what would have been imports from a country outside the FTA. In other words, if the United States and the EU establish an FTA, China's exports would decline owing to being crowded out by the increase of the EU's exports to the U.S. market or of U.S. exports to the EU. Specifically, we use ESI (Export Similarity Index) to calculate the competing relationship between Chinese and European exports, as well as between Chinese and American exports. The ESI range is between 0 and 100. The higher the ESI, the more competitive the relationship is between Chinese and European or American exports. Using an ESI index based on the 2012 HS2 data of the U.S. International Trade Commission (USITC) and the Eurostat, we found that the similarity index of Chinese and European exports in the U.S. market is 45, while the similarity index of Chinese and American exports in the EU market is 46.4. This result shows that Chinese exports are competing with European and American exports to some extent. We also predict that, as Chinese products continue to climb the ladder of the value chain, the similarities between Chinese products and American and European ones would continue to increase, subsequently leading to more competition.

To further analyze the potential "trade diversion effects," we looked into the top 20 categories of Chinese exports to the United States and the EU by comparing them with the top 20 categories of European exports to the United States and U.S. exports to the EU, giving us a deeper knowledge of the similarities. We found that in the U.S. market in 2012, 10 categories of Chinese and European exports are the same (Chs 85, 84, 94, 39, 73, 87, 90, 29, 40, and 71 of the two-digit Harmonized System tariff code or HS 2), arranged in descending order.[3] The Top 20 categories represented 89.8 percent of Chinese exports to the United States, and 88.1 percent of European exports to the United States.[4] Equally, in the European market, we found that nine categories of Chinese and American exports are the same (Chs. 85, 84, 39, 73, 29, 90, 87, 40, and 71 in order). The Top 20 categories represent 87.3 percent of Chinese exports to the EU and 88.2 percent of U.S. exports to the EU.[5] The more detailed findings are summarized in Table 1.

For the competing categories of Chinese, European, and U.S. exports, there are potential trade diversions, but the effects vary depending on the current tariff level. If the level is very low, the trade diversion would be marginal even after trade in goods were fully liberalized. If the tariff level is high, the trade diversion would be higher. Specifically, in the U.S. market, the tariff level for Ch. 40 (rubbers and articles thereof) is high. Chinese exports would face significant trade diversion once the tariffs were removed for European exports of that chapter to the U.S. market. We estimate that the affected value would be around $5 billion. The tariff level for Chs. 87 (vehicles other than railway or tramway rolling stock), 90 (optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments, and accessories) 29 (organic chemicals) and 39 (plastics and articles thereof) is between 2 percent and 4 percent, we would then reason that the trade diversion would be considerable, affecting around $39 billion worth of Chinese exports. The tariff level for Chs. 84 (nuclear reactors, boilers, machinery and mechanical appliances, computers), 85

Table 1. Comparison Among Chinese, U.S. and European Exports in 2012

Export Share (to China)				Import Share (from China)			
HS2	China	HS2	EU	HS2	China	HS2	U.S.
85	113,322	84	65,783	85	76556	84	38368
84	102,164	87	45,449	84	61964	27	19719
94	24,786	30	38,889	62	14738	30	19166
95	23,104	27	25,603	61	12495	90	19085
64	17,876	90	25,599	94	12260	88	15548
61	15,552	29	24,094	95	11386	85	14075
62	15,299	85	22,752	64	7788	29	10551
39	13,158	98	16,233	39	6619	71	9737
73	10,120	22	11,727	73	6528	87	8561
87	10,003	88	10,503	29	6396	39	5673
90	9,043	71	8,029	90	6328	38	4361
42	8,890	73	7,188	42	6081	97	2284
63	6,761	39	6,796	87	4698	99	1922
29	6,668	97	6,385	63	3104	73	1806
40	5,028	72	6,038	89	2953	33	1735
83	4,088	33	5,513	40	2859	40	1734
71	3,725	28	4,531	72	2637	8	1604
44	3,493	38	4,261	83	2596	26	1523
82	3,241	40	3,804	82	2344	28	1518
48	2,787	94	3,550	71	2292	48	1328

Data Sources: USITC, Eurostat[6]

(electrical machinery, equipment and parts, telecommunications equipment, sound recorders, television recorders), 71 (pearls, stones, prec. stones, precious metals, imitation jewelry, coins), 73 (articles of iron or steel), and 94 (furniture, bedding, cushions, lamps and lighting fittings, Nesol, illuminated signs, nameplates and the like, prefabricated buildings) is less than 2 percent. Therefore, using the data in Table 1, we conclude that the trade diversion effects would be marginal even though those chapters represent exports to the United States worth more than $250 billion.

In the EU market, the tariff level for Chs. 29 (see above), 87 (see above), 39 (see above) and 40 (rubbers and articles thereof) are high (more than 4 percent). Chinese exports would face significant trade diversion once the tariffs were removed for U.S. exports to the EU market under those chapters. We estimate that the affected value would be around 20.6 billion Euros. Since the tariff level for Chs. 84 (see above), 90 (see above) and 85 (see above) is between 2 percent and 4 percent, we believe that the trade diversion would be considerable, involving 145 billion Euros worth of exports to the EU. For Chs. 71 (see above), 73 (see above) and 94 (see above) the tariff level is low—less than 2 percent—therefore trade diversion effects of Chinese exports to the EU would be only marginal, affecting only 9 billion Euros, as calculated using the data in Table 1. Generally speaking, TTIP-induced trade diversion effects on China would be more significant in the EU market than in the U.S. market, largely because the EU market has, on average, higher levels of tariffs than the U.S. market.

Table 2. Implications of TTIP for Chinese Exports

	U.S. Market			EU Market		
Import Tariff Rate	HS2 Chapters	Value of Chinese Exports Affected by TTIP (billion US$)	Impact Level	HS2 Chapters	Value of Chinese Exports Affected by TTIP (billion Euro)	Impact Level
>4%	40	5.028	Significant	29, 87, 39, 40	20.572	Significant
2%-4%	87, 90, 29, 39	38.872	Considerable	84, 90, 85	144.848	Considerable
<2%	84, 85, 71, 73, 94	254.117	Marginal	71, 73	8.820	Marginal

Data Sources: World Tariff Profiles 2012, WTO; USITC[7]

In addition to creating the above "trade diversion effects," TTIP would also have trade creation effects, which could benefit China. A study done by the Centre for Economic Policy Research suggests, however,[8] that these effects could do no more than help China to increase exports by 0.5 percent and its GDP by 4 to 5 billion Euros, equivalent to 0.02-0.03 percent of its GDP. As Table 2 shows, the value of Chinese exports considerably affected by TTIP trade diversion effects would be 199.6 billion Euros. Even if the actual trade diversion were only 10 percent, the total value would be as high as around 20 billion Euros, roughly 1 percent of total exports and 0.3 percent of China's GDP. Therefore, we believe that the cost imposed by TTIP trade diversion on China is much larger than the potential benefits of TTIP's trade creation.

Rules Effects might also worry the Chinese government, more specifically, who controls the rule-setting power. For decades, China has been pursuing a new international economic order together with other developing countries. There is a strong groundswell within China to say farewell to the old days when others set the rules. Through TTIP, the United States and EU, as suggested by both parties, will develop a new generation of global trading rules concerning state-owned enterprises, subsidies, intellectual property rights, public procurement, raw materials, and environmental and labor standards—all areas for which China is most criticized for not obeying global trading rules. Once the transatlantic community sets new rules, Chinese exports would face new difficulties. Equally, China will find it more difficult to negotiate new trade deals with the United States and EU. These factors might lead to new flashpoints of trade tensions. Here, we offer two examples of the potential rules effects resulting from the conclusion of the TTIP: government procurement and state-owned enterprises.

Government Procurement

As the initial EU position paper on government procurement states, "this negotiation (TTIP) would present an important opportunity for the EU and the U.S. to develop together some useful 'GPA plus' elements to complement the revised GPA disciplines… A model text agreed between the EU and the U.S., being the two largest trading partners in the world, could thus possibly set a higher standard that could inspire a future GPA revision."[9] China committed itself to joining the Government Procurement Agreement when joining the WTO, and in 2007 started the accession negotiations. Due to differences in the level of ambition, China's several offers have fallen short of the expectations of GPA contracting parties. The high ambitions set by the EU and the United States in their TTIP negotiations would make China's accession to the GPA an even more daunting task.

State-Owned Enterprises

In the TTIP negotiations, the United States seeks to establish appropriate, globally relevant disciplines on state trading enterprises, SOEs, and designated monopolies, such as disciplines that promote transparency and reduce trade distortions.[10] Similarly, the objective of the EU is to create an ambitious and comprehensive global standard to discipline state involvement and influence in private and public enterprises, building and expanding on the existing WTO rules. The EU believes that could pave the way for other bilateral agreements to follow a similar approach and eventually contribute to future multilateral engagement.[11] China is well known for the significant role played by the SOEs in its economy. China's model of economic growth is even described as "state capitalism" (as opposed to free market capitalism).[12] It is foreseeable that China in the one camp and the EU and the United States in the other might compete fiercely for world market shares based on their own economic growth model, and against that background, the debate on the SOEs rules would be of even greater significance.

The Implications of the EU-Japan FTA for China

The completion of the EU-Japan FTA would give the EU much better access to the Japanese market, and vice versa, both of which mean disadvantages for China's market access to those two markets. As Table 3 shows, the percentage of zero tariff imports of Japan from China is 70.3 percent and from the EU is 48.7 percent. Once the EU-Japan FTA is completed, the categories of European exports to Japan subject to zero tariff treatment will increase significantly, exerting a huge impact on Chinese exports to Japan. Another look at the treatment of Chinese and Japanese exports in the EU market shows that 49.6 percent of the total value of Chinese exports are free of duties while the figure for Japan is 44.0 percent. With the completion of the EU-Japan FTA, a significant increase in the value of Japanese exports subject to zero tariff treatment will be realized. Again, Chinese exports to the EU will be put at a disadvantage.

Table 3. Non-Agricultural Import Tariffs of Japan and the EU in 2010

	Arithmetically average	Weighted average	Percentage of zero tariff imports (categories)	Percentage of zero tariff imports (value)
JAPANESE IMPORTS OF NON-AGRICULTURAL PRODUCTS FROM:				
China	3.8	2.6	70.3	77
EU	3.7	1.6	48.7	72.8
EU IMPORTS OF NON-AGRICULTURAL PRODUCTS FROM:				
China	4.4	3.3	24.9	49.6
Japan	4.4	3.0	23.0	44.0

Data source: World Tariff Profiles 2012, WTO, pp. 66-97[13]

Using an ESI index based on the 2011 HS2 data of Eurostat and Statistics Japan (Statistics Bureau of Japanese Ministry of Internal Affairs and Communications), we found that the similarity index of Chinese and European exports in the Japanese market is 66, while the similarity index of Chinese and Japanese exports in the EU market is 58. This shows that Chinese exports are competing with European and Japanese exports respectively in the Japanese and European markets to a great extent. As Chinese products continue to climb the value chain, the similarities would continue to increase, leading to more competition.

To further analyze potential trade diversion effects, we looked into the top 20 categories of Chinese exports to the EU and Japan by comparing them with the top 20 categories of Japanese exports to the EU and of EU exports to Japan. We thereby gained more insight into the similarities of Chinese products and Japanese and European ones. We found that in the Japanese market in 2011, eight categories of Chinese and European exports represent 69.8 percent of Chinese exports to Japan and 86.4 percent of European exports to Japan. Equally, in the European market, we found that 13 categories of Chinese and Japanese exports, respectively Chs 85, 84, 95, 73, 39, 29, 90, 87, 89, 72, 40, 71 and 82, represent 87.0 percent of Chinese exports to the EU and 94.1 percent of Japanese exports to the EU.

For competing categories of Chinese, European, and Japanese exports, there are potential trade diversions, but the diversion effects vary depending on the current tariff level. Again, if it were very low, the trade diversion would be marginal even after trade in goods is fully liberalized. If it were high, the trade diversion would be higher. Specifically, in the

Table 4. The Top 8 Categories of Chinese and European Exports to Japan in 2011

Japanese Market (Unit: million JPY)		
Categories	China	EU
Food	747,060	780,661
Raw Materials	183,140	212,978
Fossil Fuels	146,826	42,649
Chemical Products	1,059,309	2,028,857
Industrial Manufactured Products	1,807,126	478,143
Non-electrical Machinery	2,366,682	681,312
Electrical Machinery	3,635,148	547,548
Transport Equipment	277,630	768,974
Others	4,419,026	860,886

Data source: Bureau of Japanese Ministry of Internal Affairs and Communications[14]

Table 5. Top 20 Categories of Chinese and Japanese Exports to the EU in 2011

EU Market (Unit: Million Euros)			
HS2	China	HS2	Japan
85	79,809	84	18,637
84	58,056	85	13,087
62	16,381	87	12,344
61	13,671	90	5,749
95	12,643	29	2,375
94	11,507	71	2,372
64	7,583	39	1,823
73	6,584	40	1,723
39	6,170	38	1,048
29	5,943	73	1,035
42	5,853	30	1,005
90	5,662	32	714
87	4,576	37	570
89	4,217	95	479
72	3,791	82	450
63	3,127	72	443
40	2,988	89	365
83	2,432	28	327
71	2,321	96	325
82	2,208	99	297

Data source: European Commission, Eurostat[15]

Japanese market, the tariff level for food and fossil fuels is relatively high. We would assume that trade diversion would be significant, affecting around 894 billion Yen (JPY) (around $9 billion) worth of Chinese exports. The tariff level for chemical products is moderate, affecting 1.0593 trillion JPY ($10.7 billion) worth of Chinese exports. The levels for raw materials, non-electrical machinery, electrical machinery, transport equipment, and industrial manufactured products are low. We assume marginal trade diversion effects, even though total Chinese exports of those categories would be 8.270 trillion JPY ($83.4 billion).

In the EU market, the tariff levels for Chs. 29 (see above), 87 (see above), 89 (ships, boats, and floating structures), 39 (see above), and 40 (see above) are high—more than 4 percent. Chinese exports would face significant trade diversion once the tariffs were removed for Japanese exports to the EU market under those chapters. We estimate that the affected value would be around 23.896 billion Euros. Since the tariff level for Chs. 82 (tools, implements, cutlery, spoons and forks of base metal, parts thereof of base metal), 84 (see above), 90 (see above) and 85 (see above) and 95 (toys, games and sports requisites, parts and accessories thereof) is between 2 percent and 4 percent, we believe that the trade diversion for those chapters would be considerable, involving 158.379 billion Euros worth of Chinese exports to the EU. For Chs. 71 (see above), and 73 (see above), the tariff level is low—less than 2 percent; therefore the trade diversion effect of exports to the EU would be only marginal, affecting 12.696 billion Euros.

In general, the trade diversion effects on China would be roughly the same in the EU market and the Japanese market, because both markets have, on average, a sizable tariff rate compared to the U.S. market. As Table 6 suggests, the values of Chinese exports significantly affected by the EU-Japan FTA trade diversion effects would be $258.7 billion (around 200 billion Euros). Even if the actual trade diversion were only 10 percent, the total value would be as high as 20 billion Euros, roughly 1 percent of China's total exports and 0.3 percent of China's GDP.

China's Response So Far

Given the above contexts, Chinese policy-makers are faced with three broad questions: Multilateralism or bilateralism? Competing bilateralism or harmonious bilateralism? Further reform or turning inward?

Multilateralism or Bilateralism?

China is accelerating implementation of its FTA strategy. It recently concluded an FTA with Switzerland, the first major economy in Europe with which China signed a FTA. China has made clear that FTA priority is given to a China-Japan-Korea FTA, a China-Australia FTA, and China's FTA with the western Asia region.[16] It seems that China is giving priority to bilateralism; however, the official rhetoric does not indicate this. One of its chief trade negotiators announced that China would adhere to the position that multilateralism is the main avenue of trade while regional (bilateral) trade arrangements are complementary.[17] As China's former WTO ambassador Sun Zhenyu predicted, "Multilateralism is the ultimate direction." He commented that "Now is a special period," and that "The pendulum of trade liberalization might swing back to multilateralism at the end of the day." He also

Table 6. Implications of EU-Japan FTA for Chinese Exports

	Japanese Market			EU Market		
Import Tariff Rate	Product categories	Value of Chinese Exports Affected (billion US$)	Impact Level	HS2 Chapters	Value of Chinese Exports Affected (million Euro)	Impact Level
>4%	Food, fossil fuel	9	Significant	29, 87, 89, 39, 40	23,896	Significant
2%-4%	Chemicals	10.7	Considerable	82, 84, 90,85, 95	158,379	Considerable
<2%	Raw materials, non-electrical machinery, electrical machinery, transport equipment and industrial manufactured products	83.4	Marginal	71, 72, 73	12,696	Marginal

Data source: World Tariff Profiles 2012, WTO, and Bureau of Japanese Ministry of Internal Affairs and Communications, complied by authors

suggested that "The regional trade arrangements that we are now discussing might be multilateralized and it is necessary to agree on a set of multilateral rules for governing various regional arrangements."[18] For many Chinese trade veterans, it is impossible to give up the WTO as China is one of the biggest beneficiaries of the WTO. They fought so hard to make China join the WTO, and it is unthinkable to turn away from it.

Then, how can we explain the gap between China's official rhetoric and actual deeds? There are at least two explanations. One is that China is responding to competing pressure resulting from the FTA adventures of western powers, including Europe, the United States, and Japan. Given the potential trade diversion effects and loss of rule-setting power, China has to accelerate its own FTA efforts as a precautionary move. The second explanation is that China is using the FTA as a geostrategic tool to consolidate its influence in the Asia-Pacific region, as it is now negotiating FTAs respectively with Japan and Korea, Australia, and the Gulf Cooperation Council. With those factors in mind, China will probably continue to build its trade policy on two pillars—multilateralism and bilateralism. Priority might be given to bilateralism as the Doha Round is stuck. That being said, China prefers not to leave the world with the impression that China has given up on the Doha Round.

Competing Bilateralism or Harmonious Bilateralism?

Will the FTA initiatives by the United States, Japan, Korea, ASEAN, and other regional players create tensions in trade relations with China? This question is particularly relevant in the context of increasing U.S.-China strategic competition and China's territorial disputes with Japan, the Philippines, Vietnam, and others. China is also deeply worried about the economic implications of the TPP, TTIP, EU-Japan, and other regional economic initiatives excluding China. Those implications range from trade diversion effects to setting up new rules without China's participation.

Generally speaking, China is concerned with the latest trends of heightened bilateralism and regionalism in the Asia-Pacific region, which is no longer harmonious, but is generating considerable tension. China's ideal of a "harmonious world" is colliding with the cold fact of "competing bilateralism." Against that background, China's possible responses might be pragmatism in action combined with idealist rhetoric. A lack of multilateral governance of world trade may lead to more bilateral trade tensions between China and its western trading partners. China is now pushing through three overlapping regional initiatives of economic integration— China-Korea FTA, China-Japan-Korea FTA, and RCEP. It remains unclear which among the three is given top priority. All three may be affected by prominent hindrances, including territorial disputes.

Further Reform or Turning Inward?

TPP, TTIP, Japan's FTA with the EU, together with FTAs launched by other western economies are creating external pressure on China's domestic reform and opening-up. The timing is opportune, considering the arrival of a new generation of more reform-oriented top leaders. A good example is the fact that Li Keqiang took credit for launching the China-Switzerland FTA when he was vice premier and concluding that FTA during his first trip in Europe in May 2013 after assuming the premiership.

It seems increasingly obvious that the new leadership is cleverly using external pressure for pushing forward domestic reform. During his meeting with Obama, Xi Jinping announced that China was studying pushing through a mid- and long-term comprehensive reform program,[19] which was finally announced during the third plenary session of the 18th Congress. Li's patronage of China's FTA with Switzerland might open a new era for FTA negotiations with developed economies, including Australia first and then the EU second. Li's predecessor premier Wen Jiabao had already proposed a FTA feasibility study with the EU last year. The conclusion of the trilateral China-Japan-Korea is also at the top of China's FTA strategy list. All these FTAs are potential drivers for China's domestic reform.

Predicting China's Future Actions

China will definitely seek to play a larger role in the Asia-Pacific region, where it has the most fundamental and essential interests. Regional economic initiatives will be dealt with by the government from both strategic/political and economic perspectives. Both considerations will be present when China negotiates regional and bilateral FTAs. The question is which consideration prevails, the strategic and political or economic.

Faced with the options of RCEP, the China-Korea-Japan FTA, or TPP, China currently would rank order its preferences as China-Korea FTA, RCEP, and finally TPP. The China-Japan-Korea FTA used to be a priority, but given the territorial disputes between China and Japan and between Korea and Japan, the CJK FTA could not be advanced in a significant way in the near future. The bigger question now facing China is whether to join the camp led by the United States, the EU, and Japan, or to establish its own camp of regional economic integration. China obviously prefers the latter, but whether it could succeed in a China-Korea-Japan FTA and RCEP remains uncertain. The variables include China's capacity, political will, and interactions with other negotiating parties, in particular Japan and the United States in the background. It is equally fundamental whether the Chinese government could garner sufficient domestic support for pushing through big FTAs and whether China's reformers could establish a linkage between external pressure induced by the above-mentioned mega-FTAs and China's own domestic reform agenda.

China is bound to lead in Asian economic integration, considering the fact that it is already the world's biggest trading nation (in goods) and the second largest economy. But it has a lot of constraints, both internal and external. They restrict its capacity to convert its economic strengths into regional influence. A new development worthy of future investigation is China's new initiatives for building two grand silk roads, one to Central Asia leading to Europe, and the other with Southeast Asian countries leading to the Indian Ocean. They represent both a new and old type of regional economic integration: "old" in the sense that China's way of Asian economic integration is still traditional since it relies on aid and credit in helping countries to build infrastructure and promote trade with China; "new" in the sense that China is finding the confidence to rediscover its role in Asia.

Endnotes

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