



China and the WTO

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Introduction

Few events in recent decades have been as epochal as the 'opening to the outside world' of the Peoples' Republic of China, which was masterminded by Deng Xiaopeng, when he became China's leader in December 1978. In a quarter of a century China has become to a major trading nation. Its exports exploded from around \$2 billion in the late 1970's to \$355 billion in 2003; they have grown much faster than overall world trade and naturally, China's imports have grown in similar increments. The composition of China's exports has changed beyond recognition: in the early 1990's, textiles and light manufacturing still made up more than 40% of the export portfolio, the same figure which today is represented by machinery, transport and electronics (up from 17 % in 1993). China accounts for 3.3% of exports from the EU and for 6.9% of its imports (adjusted for intra-EU trade flows) in 2003. The trade balance of the EU (and of the USA, even to a larger extent) with China has been in deficit for many years. In 2003 and in 2004, trade between the two partners has been buoyant in both directions. Thus, China has become a major player in international trade.

Even more strikingly, China has become a highly open economy, in relative terms; today, the sum of exports and gross domestic product (GDP) has leapt to around 70% of GDP. This is uncharacteristic for countries of continental size and/or large populations: India, Brazil, Japan and the United States in comparison do not even reach 30%.

This explosion of 'made-in-China' industrial commodities onto the world's markets was already in full swing when China effectively acceded to the WTO in December 2002. Yet, WTO membership further intensifies China's integration in the world economy. Although the full-fledged exposure to foreign competition also carries serious risks for various sectors in China, its export performance has remained impressively robust and the growth of its GDP has maintained its pace at around 9 % per annum since accession, despite recent government efforts to cool off investments and the related overproduction in several sectors.

This paper succinctly discusses the implications of WTO membership for the future role of China in its trade relations with the outside world, particularly with the EU. It also briefly looks at the participation of China in Free Trade Agreements, which are proliferating at present. A few introductory statements appear justified.

Firstly, the 'opening-up' strategy signalled a fundamental break with the previous 1949-78 system of international trade and payments, when trade flows were determined centrally, essentially in physical terms; the modest international trade relations were managed by only twelve 'foreign trade corporations, which, operating as monopolists, acted as an 'air-lock' between Chinese (state) enterprises and suppliers of China's imports. The latter, anyhow, only comprised indispensable goods that could not be produced at home. Indeed, China applied a self-reliance strategy, which denied any merits

to the international division of labour, based on ‘comparative advantage.’ Exports were activated only to the extent that they generated the foreign exchange needed to pay for indispensable imports. The domestic economy, conceptualised to be autarchic, was essentially insulated from the world economy; domestic prices were fixed by the plan authorities and were divorced from world market prices. It follows that – as was the case in the other realms of the economy – the move towards the diametrically opposite system of open international trade and payments has been an arduous undertaking, spread over several years. It involved the wholesale revamping of trade policy instruments and institutions.

One should add that, since the 15th century, the ‘Middle Kingdom’ had consistently been inward-looking, turning down commercial contacts with outside countries and this although China was until then far ahead of the rest of the world, in terms of technical knowledge. Deng Xiaopeng himself has repeatedly recalled that in 1433 a Ming emperor put a definitive end to a series of maritime expeditions, that had brought a well-equipped fleet as far as the coast of East Africa - perhaps on their way to “discovering” America? The door to China would be ‘pried’ open in 1839 by a few British vessels. This happened not on Chinese terms but was imposed by foreign intruding powers.

Secondly, the recent upsurge of exports from, and imports into China, is intimately related to China’s successful attraction of foreign direct investment (FDI), especially since 1992. Since then the financial flows connected with FDI has reached \$40 billion or even more annually. Today, China is the top destination of FDI in the world. Moreover, most FDI are of the ‘greenfield’ (new physical investments) or ‘brownfield’ (renovation investments in joint-ventures) variety, as ‘mergers and acquisitions’ by outside firms have only become significant in recent years. The economic benefits of the former category are bound to be larger for the host country.

Foreign-invested enterprises (FIEs), i.e. those that are wholly-owned and joint ventures, today account for about half of Chinese exports and an equally high percentage of imports. This derives from the fact that, roughly speaking, the first wave of domestic FDI occurred following the initiative of firms owned by ‘overseas Chinese’ mainly from Hong Kong (whereby the Hong Kong industry was almost fully relocated into China, especially into the adjoining Special Economic Zone of Shenzhen) but also from other countries in South East Asia and from Taiwan. These ventures typically catered for labour-intensive goods, intended for the world market. An additional explanatory factor is that, in order to secure approval of their projects, foreign investors often had to pledge that a specified percentage of their output would be marketed abroad. Additionally, FIE’s had to observe the ‘foreign exchange adequacy rule’ for a long time, whereby they were obliged to equate their expenditures in foreign exchange by equivalent earnings; this led them to seek outlets abroad. Such requirements are no longer in force.

It follows from this description that it is, as yet, more appropriate to speak about exports ‘from enterprises in China’ than from ‘Chinese enterprises.’ Admittedly, a growing number of wholly Chinese enterprises - either (still)

state-owned or belonging to other ownership categories (which includes the rapidly expanding private sector) - manifest themselves as strong competitors in the potentially enormous home market. And some of them are successfully aiming at market shares abroad, either by way of exports or through production abroad, thus becoming true multinationals.

It is also noteworthy that much of China's international trade are materials for further 'processing,' whereby these and intermediate goods are imported for further processing in the affiliate of the firm supplying the FDI to begin with (e.g. intra-firm trade), or through subcontracting to local enterprises (e.g. outsourcing). The latter arrangement is typical in the apparel business. It follows that the value added within China is often rather modest, and consists mainly of the (low) wages paid to the local workers. Foreign investors however, increasingly source their inputs from within China, where production is becoming more efficient and reaches higher quality.

Finally, one may add that the need to carve out a regulatory framework for FDI has provided an initial impetus to the uninterrupted flow of new laws and regulations that have been enacted in China – and implemented with varying degrees of effectiveness – since 1980, in order to conform business operations to the requirements and standards of market economies; several of them correspond to WTO rules.

2. China's accession to the WTO: its course and its main contents

As early as 1986, the PR China requested membership of the (then) General Agreement on Tariffs and Trade. Against early expectations, it would take 15 more years before membership of the World Trade Organisation (WTO) would be secured, following the pace-setting agreement with the United States, reached in November 1999. Agreement with the EU was achieved in May 2000; the EU obtained some additional concessions, as regards import duties on about 150 commodities and the access of EU operators to several service sectors.

Some political incidents, foremost the Tienanmen Square tragedy in June 1989, have at times slowed down or even momentarily halted the process. In the meantime, the revamping of the GATT into a stronger organisation with a considerably expanded agenda and enforcement powers, in the wake of the Uruguay Round (completed in 1994), entailed greater demands on China from the WTO member countries. The insistence by the United States in 1990 on a special safeguard against imports from China (see below), became a major stumbling block. China, in turn, was reluctant to forego the more lenient developing country status, although, in the early stage of the negotiations, it had renounced that status as a matter of principle.

In the end, China agreed on almost all demands by the USA and other WTO members, although it has been burdened by specific additional so called WTO-plus commitments (see below), which are not imposed on other developing country and, hence, discriminate against China. Several commentators have

wondered why China, having already scored impressive gains in international trade, has accepted such additional terms.

It is indeed remarkable that a large country - upon leaving the shackles of the centrally-managed economy - so wholeheartedly accepts the canons of the open market economy and its implications, including fiercer international competition for its own firms, which may well suffer in a number of sectors. The plausible explanation is that in the late 1980s, Chinese top leadership became convinced that the difficult transition to a market economy should not be stopped halfway, lest the economy would encounter many crippling contradictions. The accession to the WTO would allow for the country to move further ahead and to enforce some remaining, but arduous reforms. The unavoidable adjustment costs notwithstanding, WTO membership was viewed as an efficient lever to sustain the rapid growth performance of the Chinese economy, needed to solve the daunting economic and social problems that still beset Chinese society and thus to propel China towards a prominent position among the world's nations.

One must also recall that, previous to the effective entry of China into the WTO, the strictly controlled international trade and payments regime had already been reformed to a large extent. Thus, the initially very high import duties – in fact, basically irrelevant, as trade was planned in physical terms -- have been progressively lowered from an unweighted average of 56 % in 1982 to 16.4 % in 2000 for manufactured goods; their dispersion has also been narrowed considerably. Moreover, as processing trade and foreign direct investors benefited from drawback arrangements, a large spectrum of imports were actually exempted from import duties. The monopoly position of the Foreign Trade Corporations has been eroded progressively, as trading rights were granted to lower echelons of government and soon to large individual enterprises. Foreign investors were already entitled to conduct exports on their own. The exchange regime has also been reformed. The Renminbi, which had been fixed at an economically irrational overvalued rate, thereby inhibiting exports, has been devalued a few times. In order to ensure a more favourable remuneration to Chinese exporters, a dual exchange market has been operating for a number of years, previous to its merger in January 1994 at a rate of RMB 8.7 to the US dollar, not far away from the present rate of 8.287 Rmb to the dollar.

It would exceed the limits of this paper, if a detailed listing of the all clauses of China's final Accession Protocol with the EU was attempted. Hence we limit ourselves to the most salient features, and examine them in broad terms :

- *national treatment/non-discrimination*: measures and practices which discriminate against imported products or foreign companies will be removed.
- as regards *traditional trade instruments*, China will cut average tariff levels for industrial products to 8.9 % by July 2006, at the latest, and to 15% for agricultural products. These reductions in import duties continue the previous trend. Besides, these tariffs are subject to 'binding,' i.e. in future they cannot be raised above the agreed level.

- China eliminates all quotas, licences and other *non-tariff barriers to imports* by 2005.
- China agrees to open, for entry by foreign investors, several important service sectors, such as telecommunications, financial services (banking, insurance, securities), audiovisual, and many professional services. Specifically, foreign firms will be entitled to engage in trading and distribution (such as wholesale and retail trade), maintenance and transportation. This opening is of considerable importance for foreign firms, which intend to penetrate China's domestic market. Organizing distribution outlets has been fraught with difficulties.
- Apart from the reduction in tariffs, China entered into other, far reaching but complex commitments in the field of *agriculture*. In line with WTO standards, China substitutes quota's for key products (such as wheat, corn, rice, soybean oil and cotton) by equivalent tariffs. In addition, the related rule whereby a WTO member must offer entry for a specified minimum quota of such commodities at favourable rates, has been accepted by China, at the exceptionally low rate of 1 %. On above-quota imports, the Chinese tariff on wheat is 65 % - well below the 150% EU rate. Moreover, China eliminates agricultural export subsidies—a far cry from the practices used in many major economies, including the EU – and reduces domestic subsidies for agriculture.
- The WTO allows some *safeguards* to importing countries, under restrictive conditions. In its accession protocol, China had to accept a more severe treatment. Thus, whereas the so-called 'transitional product-specific safeguard mechanism,' allows the restriction of imports when 'serious injury' to domestic firms can be substantiated, in the Chinese case mere 'market disruption' can be invoked. This unfavourable treatment can be applied for twelve years after accession, i.e. until 2017. Besides, a special textile safeguard can be invoked until the end of 2008 again in case of actual or (even only) threatening market disruption; the restriction is then valid per year.
- China was also led to accept more stringent *anti-dumping* provisions than most other developing countries. For purposes of establishing the 'normal price' benchmark, China will be treated as a non-market economy (the typical categorisation for centrally-managed economies) for fifteen years — unless the targeted firm(s) can prove that they function as a market-economy participant. Prices prevailing in such an environment are not supposed to reflect genuine demand and supply constellations. The prices in question are then compared with those in other developing countries, such as Thailand or Brazil, where they are likely to exceed those in China, considering the latter's low wage level. Because of these measures, formal complaints about price dumping in China are more readily addressed. The treatment of China as a non-market economy has been reconfirmed by the EU in June 2004.
- China has also agreed to abide by the international conventions on trade-related features of *intellectual property rights* (TRIPs), such as patents and copyrights, and to renounce '*trade-related investment measures*' (TRIPs) such as local content requirements or the already mentioned 'foreign exchange balancing' prescription.

All in all, the 'WTO-plus' commitments underwritten by China are broad-based and far-reaching in scope; they are generally more stringent than those facing most developing countries that have been WTO members for longer, and even those of several OECD countries. The elimination of agricultural export subsidies is an obvious case in point. Several western observers view the restrictive covenants on China as discriminatory. They fear that the flexible scope allowed to other members for interpreting the transitional product-specific safeguard and the non-market status still applied to China for anti-dumping purposes will kindle numerous trade disputes on less than solid grounds –although so far, this safeguard has almost never been applied by importing countries.

3. China's WTO accession: domestic and international economic effects

It is obviously too early to expect solid findings, or to make definitive statements about the impact of China's accession. But a few points can already reliably be advanced.

The Chinese Economy

First, China's effective entry into the WTO did not usher in the profound transformation of the country's stance on international trade and investment. Many important steps had already been taken, especially after 1994. Thus, on manufactures, the weighted average statutory tariff which stood at 42 % in 1993 had been lowered to 16 % in 2001 and further declined to 9.5 % after accession. Non-tariff barriers had already been slashed significantly. These moves were made while the negotiations with the USA were still dragging on. The prospect for such membership and the related drive to achieve a more efficient, more market-driven economy, already acted as a powerful push. If effectively implemented, China's WTO pledges to provide a strong push toward an international trade and investment regime in which market forces predominate and state intervention is curtailed.

Secondly, China's accession has unleashed several sophisticated analyses, often jointly undertaken by Western and Chinese institutions. They generally anticipate that China will gain ampler access to foreign markets. Specific restrictions on exports by China have been lifted by a number of WTO members. Besides, China is henceforth enjoying permanently most-favoured-nation status. China will obviously benefit from the removal of trade barriers as regards commodities in which it manifests a comparative advantage. The removal of quotas on textiles within a few months is expected to boost Chinese exports, especially as regards clothing – already fuelling the alarmist perceptions of textile producers in Europe. But China is also likely to reap benefits by enhanced exports in other sectors, as higher-value manufactured goods are rapidly increasing their share of China's exports. Such further successes on the export front hinge on the further modernisation and consolidation of industrial sectors, often excessively fragmented.

So, the indirect catalytic benefits from WTO membership may prove as important as the direct ones that derive from enhanced export trade. The already substantial flow of foreign investment in China is expected to increase. Recent data confirms this trend, given the opening of many service sectors, the growth of domestic demand and the improving regulatory framework for FDI.

But these substantial benefits out of WTO accession do not come without costs, particularly the adverse effects of enlarged imports on domestic output and employment. The financial sector, agriculture and agri-business, the energy sector, chemicals and motor vehicles are generally seen as the most protected segments of the Chinese economy, about which Chinese business circles but also international observers express serious fears.

Whiles these threats exist the first years of China's involvement in the WTO-arena have not at all been catastrophic. Chinese enterprises are displaying a remarkable capacity for adaptation. Admittedly, the Chinese banking system, essentially the four large state banks, still suffer from major weaknesses, resulting from the overhang of large non-performing loans and from the lack of a market-oriented credit culture. But, according to the IMF, progress has been steady. And when, by December 2006, all major restrictions on renminbi transactions by foreign banks will be lifted, these will not have the stomach to engage in retail banking on a grand scale. Moreover, although the state banking sector is still structurally weak and might even be considered insolvent if internationally prevailing accounting standards were consistently applied, it remains solvent as it continues to collect the high savings of the Chinese population. Recent more disaggregated analyses of Chinese agriculture also show that important agricultural products, such as the widely-consumed medium-quality wheat, is only modestly protected so as to be less sensitive to the threat of imports.

Other countries (including EU)

General equilibrium analyses, which factor in the interrelatedness of a large number of economic variables, warrant the conclusion that amongst China's trading partners, the largest welfare gains would accrue to North America and Western Europe, the largest trading blocks. This finding is no surprise, as it essentially reflects the global welfare-enhancing effects of free international trade, which renders the 'international division of labour' more efficient, as countries can then make use of their comparative advantages. Particularly, the end of the quota regime in the textile field will benefit consumers, under the plausible assumption that thanks to intense international competition, lower production costs in China result in lower end-prices, thus increasing the real income of the population at large. China's demand for, say, European goods and services will also broaden: the scope for exports to, or foreign investments in China, will expand even more rapidly than today, in a potentially enormous domestic market. This is particularly true in the realm of equipment goods. The trouble is that the undeniable benefits to consumers from less encumbered international trade in the importing country are rather diffuse and not directly visible. On the other hand, job losses in a sector that has lost out to international competition are immediately visible and are a cause for concern.

The unavoidable sectoral shifts in employment in a dynamic economic space where resources are re-allocated, have a negative effect on those with painful adjustment costs.

4. The potential for friction in international trade and investment

The pace of China's opening up to the outside world has truly been remarkable, so far, as have been the results. International trade, and the initial de-collectivisation of the agricultural activities in the early eighties, have been the two main spearheads of China's unprecedented economic growth, on such a massive scale. The severe WTO-plus commitments which China came to accept, bear testimony to its basic acceptance of the rules of an open trading system and of its resolve to reach a top rank in the league of nations, thus fostering a tangible improvement in the well-being of the largest nation on earth -- still in many aspects, a developing country with an annual per capita income of barely \$1,000.

While the prospects for further substantial growth in two-way trade, and even in direct investments, between China and the EU look highly favourable, the relationships between the two partners are likely to remain affected by a certain degree of friction. Three areas of tensions should be commented upon.

Implementation

China's trading partners are concerned that the *implementation* of the commitments accepted by China will remain patchy, not so much as a result of delaying or circumventing tactics by the Chinese government, but on account of the gravitational force of deeply engrained mindsets and bureaucratic behavioural patterns. The central and local governments – in China (the term 'local' comprises all sub-central layers of government and foremost the provinces, which have an average population of around 40 million) — or the latter amongst each other, are often engaged in a struggle to appropriate economic assets or benefits for themselves. Since ancient times, centrally developed rules have had a tendency to be blunted by local authorities; or as the saying goes “ the mightiest dragon cannot crush a local snake.” Foot-dragging at local level is likely to remain a weakening factor in China's WTO compliance. Yet, in due time, this factor is bound to become less prominent, as enterprises - both foreign and Chinese - increasingly strive to cover the pan-Chinese market and overcome local protectionism.

The two most sensitive areas of trade conflicts between China and the outside partners, including the EU, are Intellectual Property Rights (IPR) and anti-dumping procedures.

Intellectual Property Protection

As already mentioned, China has accepted the international rules that provide for *Intellectual Property Protection*, for patents, industrial property, trademarks and copyrights. Bilateral agreements were already agreed with the US as early

as 1979, and were strengthened in 1992 and 1995. Counterfeiting and pirating are still rampant in China but it is far from being the only country, as digital production methods significantly reduce the cost of copying. Foreign governments and parties acknowledge that the legislation enacted in China and the repressive measures already taken, are evidence of the fact that the Chinese government is serious about stamping out counterfeiting and pirating, if to prevent inward direct investment and the related transfer of state-of the art technologies from being hampered. The Chinese side refers, for example, to the destruction of more than 10.000 sites in 2002, where counterfeit goods were produced and underlines that IPR is also not perfect in other countries. Nevertheless, foreign enterprises still complain frequently, about inadequate enforcement within China, and the unbalanced interpretation of IPR rules by Chinese administrative and judicial bodies. Counterfeiting and pirating are particularly resented when they relate to production designs or when such goods enter the international market.

The lack of an individual industrial and literary rights tradition in China, and the resulting mental attitudes, undoubtedly remain a major stumbling block for an adequate enforcement of IPR. In a centrally-planned economy, it would have been contrary to the basic tenets to recognize the innovators' entitlement to protect their new creations. It will take time before the respect of intellectual property – of increasingly vital importance in our knowledge society - becomes rooted in Chinese society at large. In the meantime, dialogue and cooperation between both sides, such as the EU-China dialogue, appears to be the most appropriate way to bring about a noticeable improvement in the observance of international IPR rules. A recent development gives hope to progress in this area: as an increasing number of successful Chinese enterprises suffer equally from counterfeiting and pirating, they have entered into an 'objective alliance' with foreign companies to urge stricter enforcement in the IPR area.

Anti-dumping

Anti-dumping (AD) measures also remain a contentious matter between China and its trading partners. Tensions occur when producing firms in the EU and elsewhere allege that imports from China occur unfairly, at below the normal value, i.e the sales price on the domestic market; and that the industry of the importing country suffers 'material injury' or is threatened by it. In such cases, WTO rules authorize a corrective measure, namely the imposition of high 'margins' upon importation.

Over the last years, the number of complaints and of subsequent anti-dumping measures has skyrocketed, especially in the sectors of base metals, chemicals and textiles. Until recently, only a few industrial countries - foremost the US and the EU - launched anti-dumping cases, in the last decade, however, a number of developing countries have entered the arena of AD disputes. India has become the top initiator of new AD cases, although the country still applies highly protective import duties.

China, introduced AD regulations in 1997 and has since also raised complaints against allegedly dumped prices. For a number of years now China been the

main target of AD complaints – well ahead of other countries. Between 1993 and 2001, as a percentage of their overall AD complaints, the cases against China raised by Mexico (42 %) and Turkey (40%) exceeded the EU and US ratio by far (21 % and 15% respectively), although these addressed a much more limited flow of goods. This data shows the extent to which China's remarkable export performance is perceived as a threat by a large number of countries not exclusively in the OECD area. This, in itself, does not prove that such fears are substantiated or that AD proceedings are the economically most efficient response.

The treatment which China came to accept following negotiations with the US and upon entry into the WTO were more onerous than those imposed on other members. Among these, the main discriminatory feature is that until 2016 WTO members can treat China as a non-market economy for AD purposes. This status holds, unless exporters in China can prove that they sell at market prices. To determine the 'dumping margin,' the importing country can refer to comparable enterprises or countries, such as Brazil or Malaysia. In the areas in which China enjoys a comparative advantage, on account of lower wages and overall production costs, such a benchmark approach will almost certainly find that China undercuts the normal price. Thus, AD complaints are more likely to be addressed by the WTO.

In June 2004 the EU declined the request to grant China market economy status, on the grounds that it was to prove it had made adequate progress on four aspects including the reliability of accounting data and the reduction in bureaucratic meddling. It was added that once such progress was reached, the request for a change in status would again be considered. The US, in turn, In agreed to reconsider the request of China for market economy status in April 2004.

Admittedly, genuine undercutting of prices in the international market should be amenable to corrective counter-measures, such as those in force in the WTO framework. This is also justified if such undercutting is not intentional but derives from faulty calculation of production costs; China is often accused of the latter, as its calculation process still have faults, despite the enactment of accounting standards in 1985.

There can be no doubt that cases of real dumping by Chinese exporters occur, as they happen elsewhere; and that subsidies to producers, through the budget or by way of favourable interest rates charged by state banks, can modify the price equation. But subsidies have been consistently slashed in recent years and much of the exports are operated by foreign firms, who cannot be expected to set prices at a loss-making level.

At the same time, there is even less doubt that AD complaints are used - and abused - as a 'protective cloak' for domestic industry in the importing country, as proven by a large body of academic research (not only about China). The methodologies for assessing the normal price can readily be twisted to the benefit of the import-competing producers. But such defensive measures can only provide temporary relief, but are no substitute for a more offensive and

forward-looking strategy, which would allow domestic industry to recapture a competitive edge.

Understandably, China resents its current non-market economy status. Most recent data shows that prices of goods and services almost fully reflect market forces and that the weight of state enterprises in the economy is shrinking steadily. The type of 'capitalism' taking hold in China even exhibits certain features that have no counterpart in mature Western economies.

Some analysts stress that in the rapidly integrating world economy AD cases basically reflect a conflict of interest between protection-seeking domestic producers, on the one hand, and importers in the same country—and hence, ultimately consumers—on the other hand, rather than between two countries, as is perhaps normally the case. Recent cases mentioned in the press, namely ladies' underwear imported into the USA from China, and bicycles imported into the EU from Vietnam (but produced there by Taiwanese firms) exemplify such a conflict. But as already mentioned earlier, in the public eye, this conflict of interest remains concealed, while unemployment in the production sector is more visible, while newly created jobs resulting from higher real income only materialize slowly, and in a diffused way.

The proliferation of AD cases worldwide is an unfortunate development. It threatens to mushroom into an 'angry game,' that could seriously disrupt international trade and could also harm the welfare of the countries that initiate them. They invite retaliation by similar measures. The fact that in the EU, anti-dumping measures only bear on 0.5 % of the EU's overall trade, reduces their impact but would not justify cases of disguised protection.

There is growing recognition that the WTO rules with respect to AD need to be refined, so as to prevent their abuse. China, now a prominent member of the WTO, is requesting such revision, and is supported by other members. One can only hope that this area might be regulated in a more orderly manner, as in battles with reciprocal AD measures there are no winners and only one loser: the international trading system.

5. China's involvement in free trade arrangements

China's accession to the WTO accelerates its integration into the global economy. But another vector of international integration and of liberalisation of international trade and investment should be briefly commented upon, with specific reference to China.

Today the world is witnessing the growth of broadly conceived 'economic partnership agreements' and of more tangible 'free trade agreements' (FTAs), between two or more countries, whereby the participants open trade relations between one another but retain their individual set of import duties vis-à-vis third countries. East Asia is one such area in which such schemes are proposed and in some cases put in motion.

Japan and Singapore are in the process of establishing a network of bilateral FTAs, even with some countries outside the region, such as Mexico. China will soon open negotiations with New Zealand and is contemplating a similar arrangement with Australia.

China itself has proposed an even more ambitious scheme with CAFTA, aimed at constructing a free-trade area between China and the free-trade area within ASEAN, by 2010 (the poorer members of ASEAN, such as Cambodia, would only join in 2015). This is a stunning project, indeed, as it would create the largest economic zone in the world, with no less than 1.700 million consumers. Admittedly, many hurdles will have to be overcome but some first steps on the road to implementation have already been taken and there seems to be a shared ambition on both sides. Japan and Korea have also indicated some interest in the scheme.

Only two relevant comments will be made here. The first is that the CAFTA concept is related to the rapid pace of regional integration in the area, against the background of the impressive growth which the countries in the region, in particular following the Asian crisis (1997-2000). In 2001, intra-regional trade between China, Japan, the four little dragons (South Korea, Taiwan, Hong Kong and Singapore) had topped 50% of total trade (not far behind intra-EU 15 trade which stood slightly above 60 %). An excellent growth performance and a greater opening these countries' economies provided favourable conditions for further liberalisation of trade.

Secondly, the emergence of China as a major commercial player also encourages economic integration within FTA schemes. Countries in South East Asia may fear the Chinese competition, which now attracts more foreign investors, to the detriment of ASEAN countries. On the other hand, the rapid growth of the Chinese economy creates worthwhile opportunities. Countries in the region that export primary goods, such as Indonesia, respond to the heavy demand from China and enjoy improving 'terms of trade.' The spread of 'fragmented production' whereby various stages in the production sequence are performed in different countries, according to their comparative advantage increases regional trade and feeds economic growth.

The countries in the region are also facing the prospect of a dominant 'giant Dragon.' Integration with China but in a wider East Asian framework perimeter appears to be the preferred option at present. It makes sense: if one cannot beat such giant, why not join him and anchor him in a wider welfare-promoting scheme ?

6. Conclusion

The rapid inclusion of China in the global economy is one of the most interesting phenomena of recent times. It elevates China to the rank of a major player in world economic and political affairs.

Abroad this ascension is most often viewed both with awe and fear. China is nowadays often portrayed as the 'world's factory.' It holds strong trump cards

in the tough game of international trade. China can supply labour intensive goods for a long time to come thanks to a vast 'reserve army' of underemployed labourers in rural areas. But concurrently, it attracts foreign firms, intent upon carving out a portion of the rapidly growing domestic market. Its high overall savings rate allows to quench most of the investment hunger through domestic means. And the country's macro-economic governance has been receiving favourable marks by international organisations, such as the IMF, for a number of years now.

One should add that the impressive growth of its economy - even if somewhat slowed to avoid overheating - not only appears sustainable in the medium term but corresponds to a imperative objective, as it allows for a significant softening of the severe imbalances and problems that beset China. The country is indeed facing daunting challenges: among them, unemployment in the cities, difficulties in financing a social security system, the still weak position of the banking system and of a number of industrial state enterprises, environmental degradation, the gap between the coastal areas and the heartlands, and between urban and rural areas.

The emergence of a 'Giant Dragon' on the scene – following that of the smaller dragons, such as South Korea, Taiwan and Malaysia refuting Gunnar Myrdal's 1966 prediction that East and South-East Asia were condemned to persistent poverty – also creates new challenges for the European Union. At the same time, it opens new opportunities linked to the acceptance of a number of responsibilities. There are a few points to be raised on that theme.

One should in a first instance praise the fact that that in a short period, (according to a World Bank estimate) not less than 350 million Chinese citizens have been lifted above the level of abject poverty. In human terms, this represents tremendous progress.

Secondly, the rapid economic integration of China in the world economy, within the WTO framework, is not only likely to increase overall world welfare, as explained earlier, but also widens the opportunities for increased contacts for Chinese and European citizens, allowing for greater cultural exchange. In a shrinking world, such prospects must be welcomed and promoted.

Thirdly, the rapid proliferation of the global markets by enterprises operating in China should not be met by overt or covert protectionist counter-measures, as likely to be suggested by pressure groups or segments of the public opinion. History is full of examples of such protectionist stances but also proves that these could at best protect sectional interests for a short while, but not reverse the shift of productive capacities to countries and regions which, thanks to their resources, emerge as the most efficient producers. In this respect, China holds solid trump cards. Redeployment of productive assets between countries now occurs at a more rapid pace than previously, largely because of technological advances; the emergence of China provides a further impetus to such phenomenon.

Fourthly, on-going technological changes and geo-political shifts in the patterns of production implies that countries and individual firms must adapt to continually changing circumstances. In a rapidly changing world, chances of success are minimal, and the risks of regression are real, if one sticks to traditional mindsets and practices. In terms of enterprise strategies this calls for a pro-active approach to devise a renewed portfolio of goods or services offered. The exploration of different outlets in rapidly growing markets, such as the Chinese one, with its many unsatisfied needs becomes a new frontier for EU firms, despite the difficulties of operating in a culturally alien environment. EU Member States and Commission should gear their policies toward supporting the dynamism of firms. These policies should foster the enhancement of skills - a central tenet of 'knowledge economies' now more than ever before.

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