Paul Hastings

CHINA MATTERS

Paul Hastings' Newsletter for Investing & Operating in the People's Republic of China

September 2006

Opening the Door to Freer Trade with China

By Scott M. Flicker and Hamilton Loeb

The prospect of bolstering trade ties and volume with one of the fastest-growing economies is an important factor driving many countries to explore bilateral Free Trade Agreements (FTAs) with China.

Parties to FTAs get preferential status for their exports, mainly in the form of lower tariffs and other reduced barriers to trade in the importing country. Ultimately, the goal is zero or very low tariffs between the parties. These arrangements normally are intended to stimulate direct exports for both parties to the FTA, often through lowering tariff barriers in one sector (e.g. manufactured goods) in order to achieve better export performance in another (e.g. business services), leading to increased production, expanded employment, and lower prices.

As the last section of this newsletter illustrates, China is emerging as a global leader in the field of FTA negotiation, with numerous FTA talks currently in progress. One aspect of the demise of the Doha Round, the now-failed effort to expand the range and reach of the WTO rules, is the proliferation of bilateral FTAs under negotiation. China has positioned itself to be particularly influential in framing the terms of the post-Doha trade climate.

Striking a Fair Balance

The impetus for countries seeking bilateral FTAs with China is clear: access to the vast and expanding Chinese market. The question is often: "What is in it for China?"

The most obvious element is elimination or reduction of tariff barriers to Chinese exports. As China's export power has grown and has moved up the product chain to more sophisticated manufactured and technology items, China faces potential political backlash in its customer countries as local industries begin to feel the effects of Chinese competition. China has sized up this danger, and its Ministry of Commerce (MOFCOM recognizes that an early set of FTAs will help block imposition of protective walls and will establish a constituency in China's trading partners of local exporters who benefit from an open China market.

Second, China sees bilateral FTAs as a means of accelerating the development of trade ties and firming up market access for Chinese goods. One lesson China has learned from negotiating its own membership in WTO (which was effective in 2001) is the cumbersome nature of multilateral trade talks and the potential for delay and derailment over ancillary issues. China's negotiators at MOFCOM recognize that, for nearly every country (whether advanced economically, like Australia, or less advanced), having a regularized and secure access to the China market is important.

Third, the most consistent impediment to expansion of Chinese imports is the proliferation of antidumping and safeguards regimes – one of the U.S.'s most widely -emulated trade innovations, which now are being implemented in numerous countries, China included, to provide some protection for domestic industries. FTAs do not eliminate the risk of antidumping duties, but they often restrain the ability of the importing country to impose quantitative restrictions or other trade impediments. MOFCOM's posture is generally that Chinese companies are on their own in figuring out how to live with routine antidumping exposure, which is a common element of global trading, but that trade remedies against Chinese goods should be limited to the antidumping provisions. FTAs help achieve that.

Fourth, bilateral FTAs provide China a means of enhancing its ties with middle-tier economies, which often feel treated as bystanders by the major trading countries in multilateral trade negotiations. In many areas these countries are at a stage of economic development relatively similar to China, and securing their goodwill through FTAs may prove useful in later rounds of trade negotiations that may be aimed at slowing the Chinese economic march.

Finally, one of China's major strategic priorities is to secure access to basic resources, especially oil and gas. Bilateral or regional FTAs, such as the one China is negotiating with the Gulf Cooperation Council (the consortium of oil-producing Middle Eastern countries), can serve to advance that central Chinese interest.

Sensitive Negotiations

Our trade team has advised on FTA negotiations dating back to NAFTA and to the U.S.-Israel Free Trade Agreement. From this experience, we draw several lessons that may be useful in assessing the prospects for China FTAs.

- **Anticipate the trade-offs.** In any FTA negotiation, there will be politically sensitive industries that each side will want to protect, to ensure economic and political stability. The most common off-limits sectors are agriculture and textiles, which have been carved out of many FTAs and which have operated for years under their own set of multilateral trade rules. While the normal WTO and FTA disciplines are being introduced slowly into agriculture and textile trade, these have proven difficult in prior FTA talks. Parties seeking to gain market access through FTA negotiations must anticipate the trade-offs that the importing country will demand, which are often the source of stalemate in FTA bargaining.

- **The tried and tested is always easiest.** There is a body now of established practice under FTAs and multilateral trade agreements, and obtaining departures from the commonly-used terms and provisions is increasingly difficult in trade negotiations. A party seeking an FTA provision should make maximum efforts to make its proposal consistent with templates agreed to in prior FTAs. Nothing is harder than pioneering new language or terms among trade negotiators.

- **Always bring friends.** The number of industry-favored provisions that trade negotiators can attempt to advance is limited. A proposal that will benefit one company's trade posture may be substantively full of merit, but it will get traded out of the package when the hard bargaining begins. Organizing the strongest available group of affected industries or companies is usually better than a go-it-alone approach to an FTA negotiation.

- **Prepare for a long haul.** Though China's FTA negotiations seem to be unfolding at a rapid pace when compared to the norm for trade talks, a party seeking to influence FTA negotiations should assume it will be a multi-year process. The political and trade personnel responsible for the negotiations are likely to change over the course of the talks, so it will be important to keep a current pulse on where the negotiating team stands and what it is hearing on your issue. Going back over ground already covered is a routine component of working in a trade negotiation environment.

Spurring FDI

FTAs normally aim at trade in goods and services, rather than investment concerns, and focus on reducing tariff, technical, and other barriers to imports. In a small number of FTAs (such as NAFTA), provisions have been added protecting foreign investment in the counterparty country.

However, most FTA negotiations leave investment issues aside, for two reasons. First, the ministry negotiating over trade terms is often not the ministry in charge of investment policy. In the U.S., for example, FDI issues are handled by the Treasury Department, while trade issues are handled by the U.S. Trade Representative. Second, the experience with trade-agreement investment provisions is decidedly mixed: NAFTA's Chapter 11 investment rules have spawned a small industry of trade litigation which is not always welcomed by the governmental authorities.[1]

The more common route to dealing with investment issues is through Bilateral Investment Treaties, which are negotiated separately to guarantee these types of protections.

1 Full disclosure: Paul Hastings lawyers have represented some of the principal participants in NAFTA Chapter 11 litigation, including the Loewen case and the Methanex case.

Swift Progress

China is aggressively pursuing FTAs with several countries. Most are still in the works or have only been in place for a short time. Here is a short summary of progress to date.

Signed FTAs

- The Closer Economic Partnership Agreement is an FTA between China, Hong Kong and Macau.
- China and Chile signed an FTA at the end of 2005 and are expected to begin negotiations on including services and investments in the current agreement later this year.
- China signed an FTA with the Association of Southeast Asian Nations (ASEAN), with the goal of creating the world's largest free-trade zone (in terms of volume and population) by 2010. One significant item is the reduction of textile tariffs by 10-20%.

Ongoing Negotiations

- In January, China concluded the third round of negotiations with the Gulf Cooperation Council (GCC), the regional economic organization comprising Saudi Arabia, the UAE, Kuwait, Oman, Qatar, and Bahrain. An FTA is expected by the end of this year.
- The fifth round of FTA negotiations between China and Australia was held in late May in Beijing. Among the sensitive issues being negotiated are opening China's services sector to Australian banks, insurance companies, telecoms providers and transport companies.
- China and New Zealand held their seventh round of FTA negotiations in late May. Key issues include dairy, wool trade and agricultural products.
- China and Pakistan are slated to sign an FTA in December; the fourth round of negotiations should be held in September in Beijing. Both countries have so far agreed to cut customs duties to zero on 1,253 tariff lines by no later than January 1, 2008.
- India has expressed come interest in an FTA with China, but has also stated that it will defer until China becomes what India views as more of a market-based economy.
- China and Uruguay announced their intent to discuss an FTA, with key items likely to include wool, frozen fish, soybean, leather and farm products.
- There is some indication that Japan is interested in negotiating an FTA with China. However, no formal discussions have begun and it is estimated they will not take place before 2009.

Paul, Hastings, Janofsky & Walker LLP is a global law firm with 1,000 lawyers in 17 offices in Asia, Europe and the United States. Paul Hastings has one of the largest, full service, multi-jurisdictional legal practices in China with over 100 legal professionals in Beijing, Shanghai and Hong Kong, and 45 lawyers in Tokyo.

Paul Hastings has built a substantial International Trade practice as trade remedy proceedings, legislation, policy disputes, investment reviews and export regulation grow more important and the pace of globalization accelerates. Centered in the Washington DC office, the practice works closely with Asia on various finance, trade and investment matters for US and Pacific Rim clients, and with Brussels for EU competition matters.

Scott Flicker is Vice Chair of Paul Hastings' Washington DC office and a member of the firm's Global Competition and Trade, Intellectual Property and Securities Litigation Practice Groups. He advises on a variety of regulatory and litigation matters. Hamilton Loeb has been a partner in the firm's Litigation Department for 20 years and his practice concentrates on three disciplines related to competition, commercial disputes, and international trade.

For further information about international trade matters, please contact:

Washington DC
Scott M. Flicker: scottflicker@paulhastings.com
Hamilton Loeb: hamiltonloeb@paulhastings.com

Shanghai
Mitch Dudek: mitchdudek@paulhastings.com

Beijing
David Livdahl: davidlivdahl@paulhastings.com