

Asian Development Bank, 2007

China's Economic Progress and its Role in Strengthening Cooperation between East and South Asia

Zhang Yunling[1]

Introduction

China has achieved great success in its economic development since it has conducted economy-wide reforms and opened itself to the outside world. Within less than three decades, China has now become a leading economy in the world, the second largest in FDI inflow, the third largest in foreign trade, the fourth largest in GDP, and an important engine for the global economic growth. One of the key factors for China's success is its integration into the world economic system, enabling it to utilize the global market resources (market, capital and technology). The WTO accession has made the Chinese economy more open, more transparent and more integrated into the world economic system. China's new regional strategy, i.e. forming FTAs with its partners, as well as its "foreign investment strategy", have deepened and will continue to further intensify its economic integration and cooperation with its partners.

In a regional perspective, the Asia-pacific is the major region from which China receives the most FDI inflows, as well as the principal destination of its exports, with the US and Japan being the two largest markets. East Asia accounts for half of China's foreign trade and more than 70% of FDI inflow. China's trade with South Asia is still small in volume, but high in growth rate. With the emergence of the Indian economy, trade and services between China and India have increased very rapidly in the recent years.

Economic relations between East Asia and South Asia used to be very weak. But this now seems to change with Indian economic dynamism and its active "Eastward strategy". Considering its geographical location and its further economic expansion, China can play an important and special role in bridging East and South Asian regions through trade, investment, service, technology, as well as broad economic cooperation activities.

I. China's External Economic Relations

I.1. China's Economic progress

China has achieved great success since its economic reform and opening to the world since 1978. China's average growth of GDP was 9.6% during the period of 1979-2005. (Figure I.1). With the robust economy growing, China has had one of the fastest GDP growth rates in the

world and has been ranked as the fourth largest economy of the world in 2005. In the next decade, China's GDP growth may slightly go down, but is still expected to maintain its dynamism.

Figure I.1 China's growth rate of GDP (1990-2005) (%)

Source: China's Yearbook of Statistics (1991-2005 versions) and <http://www.stats.gov.cn/>

The rise in China's GDP per capita has equally been rapid. In 1990, China's GDP per capita was only US\$342 based on market exchange rate weights. This doubled to a little more than US\$700 in 1997 and again in 2005, when per capita GDP reached US\$ 1703 (figure 1.2).

Figure I.2 China's GDP per capita at current market price (1990-2005) (US\$)

Source: China's Yearbook of Statistics (1991-2005 versions) and <http://www.stats.gov.cn/>

As a consequence, strides have been made in poverty reduction as well. The number of people living below the poverty line in the rural areas fell from 250 million in 1978 to less than 100 million in 1990, and further down to 26.1 million in 2004. At the same time, the headcount ratio, which is the proportion of the poor in the total rural population, also went down from 30.7% in 1978, to 10% in 1990 to 2.8% in 2004 (figure I.3). Due to its efforts, China met the UN Millennium Development Goals (MDGs) in advance.

Figure I.3 Indicators of the Aggregate Poverty Headcount and Poverty Headcount ratio (or incidence of poverty) in the rural areas of China(1978 - 2004) (10,000, %)

Sources: National Bureau of Statistics, China, "Statistical Bulletin on Poverty Monitoring in China's rural area,www.stats.gov.cn.

I.2 External Economic Relations

Economic Openness

China's trade dependency ratio increased from 35% in 1990 to 65% in 2005, and the ratio of exports and import to total GDP also rose from less than 20% in 1990 to more than 30% in 2005. This shows the growing dependency of the economy on the external market, as well as its increasing integration into the world market (see Figure I.4).

Figure I.4 China's economic openness in terms of trade (%)

Sources: China's Yearbook of Statistics (1991-2005 versions) and <http://www.stats.gov.cn/>

The size of FDI flow to China has grown significantly, with the share of FDI stock in GDP as high as 28% in 2005. But the share of FDI inflows into China in CFGF is decreasing, to 5.6 percent in 2005 from the peak in 1994. This implies that the role of FDI in China's total investment is becoming less important relative to domestic investments.

However, FDI remains critical in supporting Chinese economic growth. With economic progress, FDI may even induce structural adjustments, such as the shift from labor intensive to capital and technology intensive sectors. Although the open FDI policy will remain, the Chinese government will be introducing a selection criteria in order to manage the impact of FDI on the rest of the economy.

Figure I.5 China's economic openness in terms of FDI (%)

Source: China's Yearbook of Statistics (1991-2005 versions) and <http://www.stats.gov.cn/>

External Economic Cooperation

China has actively pursued a number of FTAs with its trading partners (table I.1). China-ASEAN FTA is its first FTA initiative after joining WTO in 2000, introducing the concept of an early harvest program (liberalizing 600 farm products). The negotiations with ASEAN on trade in goods was signed in 2005, while the provisions covering services and investment are still under negotiations. Subsequently, more FTAs with countries in East Asia, the Asia-Pacific, were initiated. China has also actively participated in some regional cooperation institutions, such as APEC, "10+3" (ASEAN plus China, Japan, and Korea), Shanghai Cooperation Organization (SCO) and the Asia-Pacific Trade Agreement (formally, Bangkok Agreement). More recently, China has made new efforts to improve the economic relations with South Asian countries. An FTA has been signed with Pakistan in 2005, for instance, which also carry an early harvest program. A feasibility study of a China-India FTA is now underway. China became an observer of South Asian Association for Regional Cooperation (SAARC) in 2006, which opens a new avenue for broadening economic ties with the rest of South Asia.

Strengthening the economic relationship with its trading partners is one of China's major regional strategies. Experience have shown how these agreements seem to have facilitated trade, and opened up new markets. The so-called "spaghetti effect" caused by the different and overlapping rules of origins (ROOs), is however, a cause for concern as they instead create some new barriers to trade. FTAs also provide venues that help improve relations with its regional partners

in general. For example, the China-ASEAN (CAFTA) has been having a clear positive impact on the political relations between China and ASEAN countries.

Table I.1 FTA initiatives with regional partners

Source: Ministry of Commerce, China, www.mofcom.gov.cn

And Ministry of Foreign Affairs, China, www.fmprc.gov.cn.

Table I.2 Other Regional Economic Arrangements

Source: Ministry of Commerce, China, www.mofcom.gov.cn

And Ministry of Foreign Affairs, China, www.fmprc.gov.cn.

II. FDI Flow and China's FDI Management

II.1 . FDI Inflow to China

China has adopted a FDI-friendly policy since its opening to the outside world from the late 1970s. However, despite of various measures to attract FDI in the early period of 1979-1983, FDI inflow in China was a modest amount of a few hundred million dollars annually, and FDI was mainly directed to its four special economic zones (SEZs). Starting from early 1990s, however, China has attracted substantial amounts of FDI, with inflows amounting to US\$4.37 billion in 1991, US\$ 11 billion in 1992 and to US\$ 28 billion in 1993. Consequently, China became the largest FDI recipient among the developing countries and the world's 2nd largest FDI recipient overall after the United States. This trend of rapid growth continued in the following years. China's FDI inflow increased from US\$ 34 billion in 1994 to US\$ 45 billion in 1998, and although there was a slight fall in FDI inflows the year after, the annual growth rate exceeded 10%, and annual inflows reached to US\$60.3 billion in 2005.

Figure II.1. FDI inflow of China (1979-2005)

Sources: Foreign Investment Department of Ministry of Commerce, PRC.

Table I1.1 China's FDI inflows by sector, 2005 (Million S\$)

Source: MOFCOM.

As of 2005, the total accumulated FDI in China is US\$622 billion. As shown in figure II.2, from 1997 to 2004, China's Hong Kong, Taiwan and Macao (HTM) were the major investors, accounting for 44.11% of the total accumulated FDI inflow, followed by Japan (8.47%), ASEAN

(6.75%) and Republic of Korea (Korea, 5.79%). Though FDI from East Asia has declined in recent years, the region remains to be the leading foreign investors in China. FDI from the United States and EU are also sizable, accounting for 8.75% and 8.60%, of total FDI, respectively. The combined share of the rest-of-the-world is only 17.53%.

By the end of 2004, the Asia 10 economies (HTM[2], Indonesia, Japan, Malaysia, the Philippines, Singapore, Korea, Thailand) shared 70.22% of the China's total accumulated FDI (US\$562.1 billion)[3].

FDI from South Asia to China is still small, though the growth rate is considerable. From 1990 to 1997, the annual growth rate of China's FDI inflow is 171.1%, while the annual growth rates of FDI inflow from South Asia and East Asia[4] are 557.1%, 166.8% respectively. (Table II.2 and Table II.3).

Figure II.2. The structure of FDI sources to China

Sources: calculated from the reports issued by China National State Statistical Bureau, 1997-2005.

Table II.2 China's FDI inflow from East Asia and South Asia (1990-2005) unit:10,000\$)

Notes: ① South Asia here only includes Bangladesh, India, Nepal, Pakistan, and Sri Lanka. East Asia-1 includes ASEAN10, Korea and Japan. East Asia -2 includes East Asia-1; Hong Kong, Macao and Taiwan, China.

Sources: Chinese statistics yearbook, 1990-2006.

The unprecedented growth of FDI has been accompanied by China's outstanding progress in foreign trade and economic development. In general, FDI has brought in capital, technology and management know-how, stimulated reform of state-owned enterprises, upgraded work-force skills, generated employment, increased tax revenue, and ultimately, contributed to the growth of output and incomes. (Table II.3). In addition to its important role in China's economic growth, FDI has also helped accelerate the transition of Chinese economy to a market system and integration into the world economy.

Table II.3 Contribution of China's FDI inflow to Chinese Economic growth (1993-2004)

Source: <http://www.fdi.gov.cn>; <http://www.mofcom.gov.cn>.

II. 2 China's FDI Management

Many laws and regulations have been promulgated since late 1970s when China opened up its door to the outside world. The examples of which are the *Sino-foreign Equity Joint Venture Law of PRC* (1979), *Sino-foreign Cooperative Joint Venture Law of PRC* (1986), and the *Wholly Foreign Owned Enterprise Law of PRC* (1988). Together with their implementing rules, and several revisions thereafter, these are the main rules and principles governing the FDI activities in China. The *Catalogue for the Guidance of Foreign Investment Industries* is another important regulation acting as the framework from which the State approves FDI projects and grants concessions. Foreign commercial enterprises must conduct their investments according to this catalogue which classifies various business sectors into four categories: encouraged, permitted, restricted, and prohibited.

Generally speaking, China regulates FDIs at different levels, with the State Council being the highest governing body agency. The NDRC and its local counterparts are in charge of the approval of FDI projects. According to Interim Foreign Investment Project Ratification Administrative Procedures promulgated by NDRC in 2004, projects with a total investment of US\$100 million or more in the "encouraged" or "permitted" categories, or US\$50 million or more in the "restricted" category, must be reported to NDRC for ratification; applications for projects in the "encouraged" or "permitted" categories, where the total investment amount is US\$500 million or above, or in the "restricted" category where the total investment is US\$100 million or above, will be submitted to the State Council for final verification (after the NDRC has examined and verified the application). For "encouraged" or "permitted" category projects, where the total investment is below US\$100 million and "restricted" category projects, where the total investment is below US\$50 million, they must be ratified by the local NDRC; of these, "restricted" category projects must be ratified by provincial-level NDRC, and this ratification right cannot be delegated down to lower level bodies.

However, it is the MOFCOM and its local counterparts, who are considered as the main regulatory body in charged of examination and approval of FDI. The scope of MOFCOM's responsibilities mainly cover the formulation of corresponding laws and regulations, examination and approval of the establishment of capital increases over the US\$ 100 million benchmark for foreign-invested enterprises within the "encouraged" and "permitted" categories, as well as the capital increase over US\$ 50 million for the enterprises within the "restricted" category. As for the projects within the "encouraged" and "permitted" categories, whose capital increase do not exceed US\$ 100 million, and firms in restricted categories where the capital increase do not exceed US\$ 50 million, approvals can be handled by the local units of the MOFCOM. However, the record filing of such projects is subject to MOC.

In order to attracting more FDIs, China provides many kinds of incentives, such as access to information and technology assistance; facilitation of financing; tax incentives; investment guaranty program; establishment of Export Producing Zones (EPZs); etc. Among them, tax incentives are the primary measures, which are dispensed with in a complex system involving national and local levels. Moreover, exemptions, reductions and refunds are granted depending on the business type, sector, or location of the investments.

This complexity is due to the manner in which these incentives are intended to serve regional economic development and industrial development goals . Tax incentives, for instance, are used to lead FDI into some targeted regions. The income tax on foreign invested enterprises (FIEs) located in special economic zones, state new- and hi-tech industrial zones, or economic and technological development zones face 15 percent levies, while those located in coastal economic open zones, special economic zones, or in the old urban district of cities where economic and technological development zones are located, pay a higher rate of 24 percent. Those engaged in projects such as energy, communications, port and dock are also taxed at the reduced rate of 15 percent. Income taxes can be still reduced by 15% after a three-year period, provided they are listed in the state-encouraged projects and located in the middle and western regions of the country. Moreover, FIEs engaged in manufacturing production and/or software development, with a production time-frame of more than ten years, may avail themselves of a two -year income tax exemption and a further three-year 50% reduction on the income tax payable from the first profit-making year.

Tax concessions are also provided in order to promote exports. In addition to the two-year tax exemption and three-year tax reduction treatment, FIEs producing for export shall be allowed a reduced income tax rate of 50 percent as long as their annual exports account for 70 percent or more of their total sales volume. Technology-intensive FIEs are also encouraged. For certified technologically advanced enterprises belonging to state-encouraged production projects etc., a 50% tax reduction is available for a further three years after the above-mentioned five-year tax holiday expires.

To encourage the re-investments of profits, a 40% tax refund on taxes paid on the re-invested amount is provided for enterprises in operation for a period of no less than 5 years. Once again, taxes can still be further reduced by 15% after a three-year period, provided they are listed as being among the state-promoted projects and located in the middle and western regions.

Other FDI incentives are given by way of exemptions from value-added tax, to those considered as having transferred advanced technology. Equipment imported for foreign-invested or domestic-invested projects that are encouraged and supported by the state shall enjoy tariff and import-stage value-added tax exemption. FIEs and research centers will be exempt from paying tariffs on imported equipments, technology, and replacement parts.

China's open-door FDI policy is illustrated by the market-access commitments it has entered into in both industrial and services sectors, allowing full foreign ownership of individual enterprises in a range of sectors. There are however, ownership restrictions on 31 "strategic" sectors identified as being "restricted" in the *Catalogue for the Guidance of Foreign Investment Industries*. In 32 sectors, some foreign participation is allowed, but Chinese partners must hold the majority shareholdings or the dominant position.

II.3 Special Economic Zones (SEZs)

There are five SEZs in China: Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Province. The SEZs represented a major initial attempt to attract foreign capital, advanced technology and managerial expertise, and develop export-oriented industries. These SEZs are typically characterized by minimum bureaucracy, good infrastructure, generous tax holidays for manufacturing units, unlimited duty free imports of raw, intermediate and final goods as well as capital goods.

SEZs have experienced four development phases: the start-up stage from 1980 to 1985, when the necessary infrastructure was laid out; from 1986 to 1995, when export-oriented processing industries were developed; and from 1996 onwards, as the upgrading stage, when the shift of industrial structures were encouraged, from labor-intensive industries to technology-intensive and high value-added industries.

As more and more cities and regions in China are opened up to the outside world, the preferential policies exclusive for SEZs were also extended to them (e.g. coastal open cities and high-tech and industrial development zones). In particular, China's entry into the WTO in 2001 required that these SEZs develop themselves not on the basis of the application of preferential policies.

China's five SEZs proved to be very successful in attracting FDI and boosting exports. A significant part of FDI to China is concentrated there and they have contributed a lion share in China's total foreign trade. Take Shenzhen SEZ as an example, during 1999-2005, the value of foreign trade in Shenzhen SEZ alone reached more than 710 billion US dollars, 13.31% of China's total foreign trade in the same period. During 1999-2004, it attracted over 18 billion US dollars of FDI, 4.95% of China's total FDI inflow.^[5]

II. 4 China's FDI outflow

China has increasingly invested overseas as well.. While China's FDI outflow is still very small relative to global flows, the rate of growth is high, with the amount of investments rising from US\$ 0.3 billion in 1991 to US\$ 12.2 billion in 2005. By the end of 2005, the cumulative stock of China's

FDI reached over US\$ 57.2 billion. It is predicted that during the 11th Five-Year Plan (2006-2010), total outbound FDI will reach a total of US\$83.8 billion, averaging 16.8 billion dollars per year.

China's outward FDI is widely distributed in 163 countries /regions. Chinese US\$ 33.42 billion investments in Asia accounted for 74.6% of the total in 2005. The other main destinations are: Latin America US\$8.27 billion (18.5%), North America US\$0.91 billion (2.4%), Africa US\$0.9 billion (2%), Europe US\$0.75 billion (1.7%), and Oceania US\$0.54 billion (1.1%).

Most of Chinese FDI is concentrated in East Asia. In 2001-2004, 62.64% of Chinese FDI flows to East Asian region, although in recent years, there has been a rapid growth for China's FDI flows to South Asia (see Table II.4).

Table II.4 China's FDI outflow (2001-2004) (unit:10000US\$)

Notes: ①SAARC here only includes Bangladesh, India, Nepal, Pakistan, and Sri Lanka..

②The figures in parenthesis indicate the percent of China's FDI outflow into this region in total.

Source: Yearbook of China's Commerce,2005.

To implement the government's strategy to invest abroad, a series of policies have been introduced in five areas: creation of incentives; streamlining administrative procedures, including greater transparency of rules and decentralization of authority to local levels of government; easing of capital controls; relaxing the foreign exchange control; providing information and guidance on investment opportunities; and giving credit support to key overseas investment projects encouraged by the government. These promotional policies are outlined in a series documents, such as the *"Provisions on Approval Matters Relating to Investment and Establishment of Enterprises Abroad"* issued by MOFCOM on Oct. 1, 2004 (similar rules for Hong Kong/Macao issued in Aug. 2004); *"Interim Administrative Provisions on Approval of Offshore Investment Projects"*, issued by NDRC on Oct. 9, 2004; *"Circulars on foreign exchange issues relating to foreign-funded M&A and offshore investment by individuals"* issued by SAFE in Jan. 2005 (No. 11) and April 2005 (No. 29) – repealed and replaced by Circular No. 75 (effective Nov. 1, 2005); *"Catalogue of Countries and Industries for the Direction of Investments Abroad (I)"*, issued by MOFCOM and Ministry of Foreign Affairs on July 8, 2004; *"Circular on Credit Support Policy to Key Offshore Investment Projects Encouraged by the State"* issued by NDRC and China Import and Export Bank on Oct. 27, 2004.

III. China's merchandise trade and policy

III.1. China's foreign trade

China's foreign trade has grown rapidly since 1990. Total trade increased from \$115.4 billion in 1990 to \$ 1,422.1 billion in 2005, with an average annual growth rate of 18.2%. China's export increased from \$62.06 billion to \$762.0 billion, also with an average annual growth rate of 18.2%, while imports increased from \$53.4 billion to \$660.1 billion, with an average annual growth rate of 18.3%. (See Table III.1 and Chart III.1)

Table III.1 Growth of China's Foreign Trade Billion US\$, %

Source: Yearbook of China's Customs Statistics, 1990-2005.

Chart III. 1 Growth of China's Foreign Trade

Source: Source: Yearbook of China's Customs Statistics, 1990-2005

Trade with East Asia has grown faster than China's overall trade, rising from \$23.63 billion to \$426.75 billion during 1990-2005. This implies an annual growth rate of 21.3%. Imports have increased more than exports: while exports rose from \$12.98 billion to \$174.47 billion, growing annually at a rate of 18.9%, imports grew by 23.5% , representing an increase from \$10.66 billion to \$252.27 billion during the same period.[6]

With an average annual growth rate of 20.6% for exports and 29.9% in imports, China's trade is increasingly oriented towards South Asia (Bangladesh, India, Nepal, Pakistan and Sri Lanka) as well. Trade jumped from \$1.17 billion to \$26.62 billion from 1990-2005, with exports rising from \$0.96 billion to \$15.89 billion, and imports from \$0.21 billion to \$10.73 billion (See Table III.2 and III.3).

Table III. 2 China's Trade with East Asia Billion US\$, %

Note: East Asia (1) includes 10 countries of ASEAN, Japan and Korea; East Asia (2) includes 10 countries of ASEAN, Japan, Korea, and Hong Kong and Taiwan, China.

Source: Yearbook of China's Customs Statistics, 1990-2005

Table III. 3 China's Trade with South Asia Million US\$

Note: South Asia includes Bangladesh, India, Nepal, Pakistan and Sri Lanka.

Source: Yearbook of China's Customs Statistics, 1990-2005

Trade Direction

Although China's exports are predominantly destined for Asian markets, exports to North America has witnessed the fastest growth, increasing their share from 9% of total exports in 1990 to 23% in 2005. Exports to Asia fell correspondingly, from as high as 71.77%, to 48.09% during the same

period (See Table III.4). However, this change is largely due to goods being exported directly from the mainland as opposed to the past where a large share of exports were coursed through the ports of Hong Kong.

Table III. 4 Shares of China's Export by Region %

Source: Yearbook of China's Customs Statistics, 1990-2005.

The import from Asia has accounted for over half of China's total imports since the 1990's. The import share from Asia has increased from 54.37% in 1990 to 66.89% in 2005. East Asian shares in China's total trade, exports and imports account for 46.04%, 41.40% and 51.38% in 2005. In contrast, trade with South Asia did not experience obvious growth. The shares of total trade, exports and imports accounted for 1.87%, 2.09% and 1.62% respectively in 2005. (See Table III.5)

(add here more details – top destinations (more specific), top products)

Table III. 5 Shares of China's Import by Region %

Source: Yearbook of China's Customs Statistics, 1990-2005.

III. 2 Trade Protection

China's average applied MFN tariff level was 9.7% in 2005, with the average MFN tariff rates for agricultural and non-agricultural products set at 15.3% and 8.8%, respectively. In accordance with the *Information Technology Agreement (ITA)*, tariffs for all ITA products have been eliminated since January 2005, as well as non-tariff measures such as import quotas, import licenses and import tendering. The administration of the tariff rate quota system has been further improved and the amount of quotas gradually fell in line with the commitments made. Quotas for vegetable oils, for instance, were abolished on 1 January 2006, as committed. In line with the *Foreign Trade Law* as amended in April 2004, the Chinese Government liberalized the state trading rights on July 2004, six months ahead of schedule, and on 1 January 2005, state trading for silk was abolished. Designate trading was also eliminated on schedule.

Some concerns from China's trading partners remain, however. The insufficient correspondence between Chinese and international standards, for instance, leads to higher compliance costs for foreign companies operating in the Chinese market. Entry for foreign small and medium-sized enterprises (SMEs) is hindered by the costly process of applying for CCC mark exemptions, as they are required to submit their applications to the Beijing offices of Certification and Accreditation Administration of China (CNCA) in person. In addition, some laboratories

responsible for testing imported products are affiliated with domestic competitors, which not only increases the risk of industrial espionage, but could also lead to an even higher compliance costs due to more stringent SPS measures.

Table III.6 China's tariff level

Note: Data are from UNCTAD's TRAINS and Specific tariffs have been converted to ad valorem equivalents.

III. 3. Export Promotion

Trade promotion has been an important policy in China's economic development strategy. The main measures are: export credits, and export credit insurance; assistance for exporters to explore international markets; setting up institutions to promote trade by developing foreign trade relations, sponsoring exhibitions, providing information and advisory services; and facilitating exports of SMEs.

The most direct and effective measure in China's export promotion is the 1985 export value-added tax (VAT) refund system which refunds partially or completely the levied domestic taxes to export-oriented enterprises.

Table III.7 Summary of China's VAT Refund Policy

During the latest VAT refund policy readjustment, some changes were made. Sectors in agricultural products, ships, automobiles and key parts, medical appliances and some mechanical and electronics products will continue to enjoy their full refund rate of 17%. These sectors are either high-tech intensive and high value-added products encouraged by the government for the structural adjustment of exports, or as a means to protect strategic sectors that may still lack international competitiveness, such as agricultural products and automobiles etc. Some sectors which previously enjoyed the full refund rate, such as clothing, textiles, desktop computers and peripherals, home electrical appliances, for some electrical parts and articles, and apparatus and instruments, experienced a reduction in their refund rates. Currently, the government is considering of abolishing the refund for some resources products in order to discourage the exports of these products.

Two major institutions deliver export finance, insurance and guarantees. The Export-Import Bank of China (China Eximbank) is a state policy bank, which has a mandate to provide financial support in order to promote the exports of goods such as mechanical and electronic products and high-tech and new-tech products. The China Export & Credit Insurance Corporation (SINOSURE)

is the only policy-oriented Chinese insurance company specializing in export credit insurance. One function of SINOSURE is to provide export credit insurance, export financing facilitation, information, and receivables management services, as ways of promoting Chinese exports, especially those in high-tech or high added-value capital goods. SINOSURE also offers coverage against political and various commercial risks.

The Ministry of Commerce (MOFCOM) publishes information online to help export enterprises, especially, SMEs. A list of key export brands is made, including products in the mechanical and electrical industry, textiles, light industry, arts and crafts, food and food processing, metals, minerals and chemicals and pharmaceuticals aiming at enhancing the competitiveness of Chinese enterprises on the international market. Exporters on the list will enjoy various types of assistance such as export credit insurance through SINOSURE. Some special funds are also provided especially to promote the exports of SMEs, such as the “International Market Exploration Fund for SMEs”, established in 2000.

China has also used its tax system to encourage foreign investment. Foreign firms enjoy lower tax rates (15% and 24%) than domestic companies (33%) and also have access to tax holidays if they invest in targeted sectors or regions. Considering that exports by FDI enterprises account for over half of China’s total export, such tax and preferential policies play an important role in China’s export expansion.

III. 4. China’s FTA Strategy

After joining WTO, China has been active in negotiating a number of FTAs which go much beyond tariff liberalization. These FTAs are often comprehensive in nature, with institutional harmonization and a broader scope of economic cooperation (i.e., investment cooperation, training, R&D and education, etc) .

As a developing country, China has adopted a gradual liberalization approach in concluding FTAs with its partners, beginning with less sensitive products in a so-called ‘Early Harvest Program’. Table III 8-10 summarize the nature, scope, and the Rules of Origin of China’s FTAs.

Table III.8 Summary of approaches of FTA Arrangements

Table III.9 Summary of coverage of FTA agreements

Table III.10 Summary of ROO

Except for the agreements with Hong Kong and Macau, all concluded FTAs carry a sensitive product clause.[7] The China-ASEAN FTA, for instance, allows for a maximum ceiling of 400 tariff lines at the HS 6-digit level and 10% of the total import value (based on 2001 trade statistics)

for ASEAN 6 (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) and China; and 500 tariff lines at the HS 6-digit level for ASEAN newer members (or CLMV, Cambodia, Laos, Myanmar and Viet Nam), with no import value ceiling requirements. Tariff lines in the Sensitive Track are further broken down into a Sensitive and Highly Sensitive List.[8]

China and ASEAN started the Early Harvest Program from January 2004, and tariff reductions from July 20th 2005. This seems to have led to benefits reflected by the growth in trade. China-ASEAN trade grew by 35% in 2004 (US\$105.88 billion in value), and 23.1% in 2005 (\$130.37 billion). Products covered by the EHP grew even faster from 2003-2004, with exports and imports increasing by 31.2% and 46.6% respectively.

China has begun negotiations or carried out FTA feasibility studies with developed countries, such as Australia, New Zealand and Iceland.[9] Australia, for instance, is more interested in the “single package” approach on agriculture, manufacture, investment, trade in services, government procurement and intellectual property rights. The protection of intellectual property rights is a particular concern among China’s partners. From China’s side, however, energy cooperation is one of its key priorities.

IV. China’s Service Trade and Policy

IV.1 China’s Services Trade

The share of China’s service trade in total trade is still very low, accounting for about 10% of total trade in 2005, and with a value US\$158.2 billion, it represents about 7% of China’s GDP.

Services imports outpaced that exports, resulting to a deficit of US\$ 5.6 billion in 2000 and US\$ 9.4 billion in 2005.

Table IV.1 China’s trade in services and in goods(1998-2005) (Billion US\$, %)

Source: Ministry of Commerce (MOFCOM) and State Administration of Foreign Exchange (SAFE).

Table IV.2 Balance of Service Trade(1998-2005) (Billion US\$)

Source: State Administration of Foreign Exchange (SAFE).

The strength of China’s service sector is mainly on traditional serviced and low-value added projects. For example, exports of transport and tourism services accounted for over half of China’s services exports in the past decade, but banking, insurance, consulting, information,

advertising and other technology and knowledge-intensive high-value added service sectors are still in their primary stage of development.

The tourism sector earned big surplus, while the transport sector, the second biggest service export sector, had a sizeable deficit. The deficit of transport service increased from US\$ 7.9 billion in 2002 to US\$ 13 billion in 2005. In 2005, transport, tourism and other commercial services accounted for nearly four fifth of the total receipts and payments of services.

Table IV.3 shows the service trade value and changes in 2005 by sectors. In 2005, services exports totaled US\$74.4 billion while imports reached US\$83.8 billion, implying an increase of 19% and 16% respectively during the 2004-2005 period. Tourism is the major source of China's service trade surplus. Tourism income was US\$29.3 billion, with a year-on-year increase of 14%, accounting for 39% of the total services income. Tourism payment was US\$ 21.8 billion, US\$ 7.5 billion less than tourism income. Transport earned US\$15.4 billion in 2005 (up by 28% from 2004), accounting for 21%of the total services income.

The income from film/Audio & Video (AV) grew the fastest in 2005 with a rate of 227%. Second came the construction and consulting, growing by 77% and 69%, respectively. In 2005, income from sales of broadcasting rights for the 2008 Olympic Games and exports of films and other audio and video were US\$ 130 million, an increase of 227% from 2004.

China's service trade partners are mainly Hong Kong, China and the USA, contractual construction and labor services being the principal sectors. Since 1995, designing service export plays important role in China's service exports as well.

Table IV.3 China's services trade in 2005 (100 million dollars)

Source: SAFE.

Table IV. 4 China's Trade in construction, labor and designing

Source: China's Statistics and Ministry of Commerce

Table IV. 5 China's contractual construction in East Asia (1998-2004)

million US\$, %

Source: China's Statistics and Ministry of Commerce.

Table IV.6 China's labor service export to East Asia (1998-2004) million US\$, %

Source: China's Statistics and Ministry of Commerce.

In South Asia, Pakistan is one of the most important markets for Chinese contractual construction service exports. Up to the end of 2004, Chinese companies contracted 383 projects of construction, and exported machinery services. Total contractual value (from 1992) to 2004 was over US\$ 6800 million, in which construction contributed a total of US\$ 730 million. China's export of construction and labor to Sri Lanka was US\$ 610 million and the contractual value was US\$ 880 million up to 2003. China also exported construction and labor to Bangladesh since the 1980s, and in 2004, contractual value of construction exported to Bangladesh was US\$ 535 million. New construction contracts in 2004 amounted to US\$ 2.19 billion, a 90% increase from the previous year. New contracts between China and India in 2004 was valued at US\$ 0.51 billion; and contracts between China and Pakistan totaled to US\$ 1.3 billion, representing an increase of 217% from the previous year.

Table IV.7 China's contractual construction and labor service to South Asia (1998-2004, Million US\$)

Source: China's Statistics and Ministry of Commerce.

IV. 2. FDI in China's service sectors

China's FDI inflows are mainly concentrated in manufacturing sectors, which account for about 70% of total FDI inflows. FDI inflows in services slightly fell from US\$ 12 billion in 2001 to US\$11.7 billion in 2005. Compared to the total FDI in manufacturing sector of US\$ 190.2 billion (from 2001-2005), FDI in services registered a value of US\$ 63 billion (excluding the FDI inflow to finance sector). In terms of the financial services sector, 14 new foreign banks invested in China with total assets reaching US\$ 49.6 billion, from the period of China's WTO accession in 2001, till the end of 2003.

Table IV.8 FDI inflows to China's manufacturing and service sectors (2001-2005, million US\$, %)

Note: *excluding finance service.

Source: MOFCOM.

Table IV.9 Foreign financial institutions in China from 1981-2003

* Closed institutions.

Source: MOFCOM.

During 1994-2005, the total assets of foreign banks increased from US\$ 11.8 billion to US\$ 87.7 billion, representing a 7.4-fold increase. In 2005, FDI inflows in banking, insurance and securities totaled to US\$11.8 billion. The number of foreign-invested insurance companies increased from 14 in 2000 to 40 in 2005, which accounts for 7% of China's total market share. Up to end of 2005, 72 foreign banks from 21 countries and regions have established 254 affiliates in China, and 177 foreign banks from 40 countries and regions have established 240 representative offices. There were 40 foreign insurance companies investing by the end of 2005, representing half of the total 82 insurance companies in China. Their revenues have rapidly expanded; 29 times faster relative to their domestic counterparts.

From 1992 to 2005, 1,341 foreign-owned distribution enterprises had been registered in China, with foreign-owned retail shops numbering 5,657. In 2005 alone, newly established foreign-owned supermarket chains accounted for over a quarter of total FDI approvals from 1992-2004.. From 1997 to 2003, there were 2,243 foreign-operated construction enterprises, with a contractual FDI value of US\$ 11.4 billion (US\$ 7.5 billion of which is utilized).

FDI in services is mainly concentrated in real estate (US\$ 6 billion in 2004, accounting for 48.7% of the total utilized FDI in services), computer service, construction, retail, hotel and catering, warehousing and water transport

Table IV.10 China's FDI inflows to service sector, 2005 (Million US\$)

Source: MOFCOM.

IV.3. FDI Policy in service sectors

Consistent with China's WTO commitments, over 60% services have been opened-up to foreign investors. The degree of openness in developed countries generally comes to 80%, whereas in developing and transitional economies the figure averages around 20%-40%. In the case of China, the level of market access for foreign services suppliers has been significantly increased. By the end of 2005, 62% of China's service sector has been opened to the outside world, with the liberalization in telecom services, accounting services, education services offering the most market access opportunities.

Since its WTO accession, over 40 laws and regulations have been enacted in the field of banking, insurance, law services, security, retail, transport, tourism and education. The Foreign Trade Law, which came into force in July 2004, allowed foreign-invested enterprises to have full trading rights. China's Catalogue for the Guidance of Foreign Investment was revised in 2004, containing the redefinition of the restricted and prohibited foreign investment sectors. On April 16, 2004, China promulgated *Measures for the Administration of Foreign Investment in the Commercial sector*, simplified the procedures for FDI approvals. In 2005, China has further

revised its laws and regulations governing leasing, market opening-up for finished oil, franchising, auction, auto brand sales, forwarders for civil aviation and international freight.

Now the restrictions on ownership and location in finance, insurance and security services have been eliminated. But foreign financial institutions which applied to establish a subsidiary should have a total asset of more than US \$10 billion at the end of the year prior to filing the application. A branch of a foreign bank, on the other hand, need have total assets of more than US \$20 billion at the end of the year prior to filing the application. A Chinese-foreign joint finance company or bank must meet a lower minimum of US \$10 billion at the end of the year prior to filing the application. Foreign financial institutions wishing to engage in local currency trading are required to be operating in the country for three years business operation, and must display its profitability for two consecutive years prior to the application.

Foreign insurance companies are allowed to provide health insurance, group insurance and pension/annuities insurance to foreigners and Chinese without quantitative or locational restrictions. Foreign non-life insurers are allowed to have wholly-owned subsidiary, but could not engage in statutory insurance business. The investors should be a foreign insurance company which has been established for at least 30 years; have a representative office for two consecutive years in China; and possess a total asset of more than US \$5 billion at the end of the year prior to application. Insurance brokers should have total assets of more than US\$ 200 million.

Foreign securities institutions may engage directly (without Chinese intermediaries) in *B*-share business. Representative offices of foreign securities institutions may become Special Members of all Chinese stock exchanges. Joint ventures, with foreign minority ownership not exceeding 1/3, are allowed to engage in underwriting *A*-shares, and in underwriting and trading of *B* and *H* shares, as well as government and corporate debts.

Wholly foreign-owned enterprises are likewise allowed to undertake construction projects, which are financed by foreign investments and/or grants, or by loans of international financial institutions; or awarded through international tendering according to the terms of loans. The same is true for Chinese-foreign joint construction projects, as long as the foreign share is at least 50% of total venture. There are also projects where foreign expertise would be needed, or projects that would be difficult to implement by Chinese enterprises alone. In utilities networks (gas, heat, water supply and water drainage) the Chinese partner must be the majority share holder.

Wholly foreign-owned subsidiaries can freely establish in the service sectors of packaging, maintenance and repair of office machinery and equipment, rental and leasing, taxation, architecture, advertisement, management consultation, luxury hotels (real estate). Foreign courier services can set up wholly foreign-owned subsidiaries except for those currently reserved for Chinese postal agencies.

Foreign majority ownership and/or joint ventures are permitted in services related to event (i.e. convention) organization, photography, translation and interpretation, high standard real estate projects (i.e. apartments and office buildings), medical treatment, equity joint ventures or contractual joint ventures in hospitals or clinics.

International law firms are also allowed to provide legal services as long as they are conducted via their representative offices.^[10] For basic telecommunication services, joint ventures are allowed but foreign share can not be over 49%. In the construction and operation of cinemas, production of broadcasting and TV programs, publishing and filmmaking, the Chinese partner must again hold the majority of shares. For offshore oil-field services, foreign firms must enter into partnerships with their Chinese counterparts, for instance, onshore oil-field services have to be undertaken in cooperation with the China National Petroleum Corporation (CNPC).

In recent years, China has stepped up its efforts in service trade legislation in order to further open up opportunities for foreign investors. For example, administration of China's foreign trade in services involves various government departments, which could play positive roles in promoting development of services trade, but there are difficulties in coordination. A complete legislation system in service sectors has not been set up, and in general, China's trade in services is characterized by imperfect laws and regulations.

In the WTO negotiations on trade in services, the requests made to China are mainly focused on reducing the minimum assets limit of banks, insurance companies and telecommunication companies; simplifying the approving procedure; opening the sectors of law service, post service, etc.

China has submitted more than 30 proposals and position papers in the WTO negotiations, which had played a positive and constructive role in advancing the negotiations, bridging understanding among WTO Members and narrowing differences. In February, 2006, China joined 3 requests on water transport, movement of natural persons and eliminating the exceptions of most favored treatment initiated by other WTO members. In the negotiations in March and May of 2006, China initiated bilateral requests from 29 WTO members including US, EU, Japan, Canada, India and Brazil on over 10 sectors including construction, water transport, health, education and tourism.

V. Infrastructure and East-South Asia Link

V.1 China's Infrastructure Improvement

In the 1990s, the burgeoning international trade aggravated the long-standing shortage of transport capacity in China. This prompted the government to launch the historically biggest investment in infrastructure construction in the late 1990s. During the 9th Five-Year Plan period

(1995-2000), the total investment in transport infrastructure construction reached 1020.9 billion RMB, among which, 885.8 billion is for highway, 42.1 billion for coastal ports and 23.1 billion for inland water.[11] It turned out to be the program with the best record in scale, speed and quality of the construction. Since then, there has been a great leap forward in supply of transport services in China.

The development of China's highway infrastructure has experienced a very high growth. The increase in mileage is enormous, with the total mileage of highway reaching 1.94 million kms by the end of 2005, while the total mileage of expressway open to traffic has surpassed 41,000 kilometers.

The improvement of highways, combined with the increase of carrying capacity of vehicles and the up-grading of technology have greatly improved the capacity and service quality of transportation. In 2005, the gross volume of passenger transport was 16.97 billion persons and the turnover reached 929.2 billion persons/ km respectively, and those of cargo transport and turnover were 13.4 billion tons and 869.3 billion tons kms., respectively. The average cargo transport distance has risen to 64.79 km. The rapid rise of highway express transport, significantly improved the efficiency of transport services and strengthened the fundamental position of highway transport in the integrated transport system.[12]

Rail is one of the dominant freight transportation modes in China. Importantly, China's energy supply is heavily dependent on railways. For example, 40% of the freight tonnage moving by rail is coal, and about 70% of China's coal moves by rail. With high increase of energy demand, pressure has been put on the rail infrastructure to move high-quality coal through longer distances out of Northern China to Southern manufacturing areas. The government has therefore reached the decision to speed up the construction of railways in the late 1990s. By 2005, the total operating railway mileage in China has reached 75,437 kms., and is now ranked as the first among the Asian countries. A railway transportation network has been constructed as well as modernized. The mileage of double-tracking railways was 25,566 km, with the rate of double-tracking reaching 33.9 percent. With Qinghai-Tibet Railway running into operation in 2006, railway services are available in all the provinces, autonomous regions and municipalities. The Chinese Mainland coast is over 18,000 km long, and its rivers total 220,000 km in length. This provide the ideal conditions for developing inland river transport and ocean shipping. In the 1990s, the construction of ports is a key focus for infrastructure development, and was in fact, supported by a series of government priority policies. For instance, China allows foreign companies to build and operate berths in the form of a joint venture; engage in loading and unloading business, cargo storage, disassembling and packaging services, as well as related passenger and cargo transport services by land and water. Foreign companies are also allowed to enter into partnership with their Chinese counterparts to engage in loading and unloading business by leasing, or to build special harbors and waterways for cargo owners with exclusive

foreign funds. These measures have promoted port construction, so that by the end of 2004, the total ports in China reached 1430, with annual cargo capacity of 4.17 billion tons.

Ocean shipping in China is divided into two major navigation zones: the northern and the southern ones. The northern one has Shanghai and Dalian as the centers, and the southern one has Guangzhou and Shenzhen as the centers. There are 11 major coastal harbors in China, with an annual cargo capacity of over hundred million tons. Shanghai Harbor, ranks the first among the trade harbors in the world (with an annual cargo capacity of 400 million ton). The other three main harbors are Ningbo Harbor (269 million tons), Guangzhou harbor(250), and Tianjin Harbor(241). As regards of cargo and container handling capacity, China retains the first place in the world in the past three years. By the end of 2005, the cargo turnover for imports and exports amounted to 1.37 billion tons, and the container turnover in more than 20 seaports reached 70 million tons.

**Table V.1 Berths and Turnover of Top Ten Foreign Trade Sea Ports in China
(2004-05)**

Sources: China Statistical Yearbook 2005.

Airports play an increasing role in connecting China and the outside world. In 2004, there were 133 airports operating scheduled flights, 39 of them having an annual passenger volume of over 1 million and cargo turnover over of 10000 tons. Moreover, China has 244 international air routes connecting 38 countries and 80 foreign cities. In 2005, the total volume of passenger traffic reached 284.35 million, and cargo turnover by air reached 6.33million tons. Its capacity handling passenger and goods ranks the third place in the world.

Table V.2 Passenger and Cargo Transport of Top Ten Airports in China, 2005

Source: <http://www.caac.gov.cn>

In the next five years, the government will continue pour huge-volume investments in transportation infrastructure construction.

Table V.3 China's Transportation Development

V.2 China and South Asia Transportation Cooperation

The traffic between China and South Asia has become busier and more convenient than ever before. In contrast with the past, when there were no air links between China and India, there are

now 9 scheduled flights between India and China every week. Some air and road links connecting China with Nepal also exist, as well as with Pakistan, Sri Lanka, and Bangladesh. China has taken new initiatives to improve its transport corridors with South Asia. China and India, for instance, agreed to jointly work towards the further enhancement of direct air and shipping links, tourism and people-to-people contacts. A Memorandum Of Understanding was also signed that will pave the way for a major liberalization of civil aviation links between China and India. China and Pakistan agreed to initiate the renovation project of the Karakoram Highway, which is the only overland connection between the two countries at present. The 809-kilometer highway, whose location is 600 to 4,700 meters above sea level, was built in 1978 for special geopolitical reasons, but was then subjected to neglect due to lack of maintenance. Since 2005, a renovation plan was designed, which will expand the width of the highway from 10 meters to 30 meters, and enhance its capacity three times. China and Bangladesh agreed to open a direct air link between Beijing of China and Dhaka of Bangladesh via Kunming. Both sides were also committed to complete the final phase of the Kunming-Chittagong road link. During the 11th-Five Plan period, China has planned to extend Qinghai-Tibet Railway from Lhasa to Shigatse, and then through Shigatse to Yadong, which is a small border town near India. A railway through Shigatse to Nilamu, a land port of entry to Nepal, is also under consideration. The railway from Dali to Ruili, a border town near Myanmar is still being studied^[13].

V.3. Facilitation Measures

In recent years, China's General Administration of Customs (GAC), together with other concerned Ministries, has focused in establishing a modern customs system. The chief priority of the reforms is clearance handling. The project is divided into the two phases.

During the first phase (1998-2002) China has made great strides in improving its customs clearance. Progress was achieved in various areas: screening, supervision of administration authorities, standardization of goods transportation enterprises management, and modernization of physical facility in some key ports customs; establishing fast customs clearance procedure in ports, and accelerating the movement of goods; nationwide use of fast customs-transfer operation, and incorporation of the "one-stop, single-window" approach to customs-transfer between inland and ports or between different customs; piloting of a "paperless customs clearance" project; implementing of the "E-customs Project" network connecting national customs; increasing customs administration effectiveness via the "E-ports Project" of data-exchange and networked joint inspection between different government departments and different regions, enhancing overall performance in ports administration and the efficiency of import and export procedures.

In the second phase from 2004 to 2010, China has planned to establish a “smart” Customs based on best practices, which will be expected to be professionally managed, highly efficient and resistant to corruption. In order to achieve these targets, China has made great efforts in the following aspects: (1) adoption of the WTO valuation agreement principles^[14]; and the (2) promotion of automation and information technology in Customs clearance (via “Electronic Customs”, “Electronic General Administration of Customs” and “Electronic Ports”); Up to now, the paperless clearance procedures have been expanded in most Customs Districts of the General Administration of Customs. This greatly increased the speed of customs clearance. At the same time, a nation-wide integrated quarantine and inspection operation management system, named CIQ 2000 system has been set up. The system implemented the computerized network management in inspection submission, fees and charges, quarantine and inspection, issuance of certification for customs clearance and statistics. It also has the functions of electronic declaration, electronic bill transfer and electronic customs clearance.

VI. Policy Recommendations

Due to its unique geographical location, its big size and continuous high economic growth, China can play a special and important role in strengthening economic relations between East Asia and South Asia.

Our study shows that China has achieved great progress in both its economic development and external relations. In the past two decades, as an emerging giant economy, China has been in a key position to develop East Asian production and service networks through trade and FDI. The Chinese economy is expected to maintain its dynamism in the future, and become even more integrated with other parts of the world.

China and South Asia have rapidly developed their trade and investment relations in the past decade. In 2005, China became the third largest export market and the first largest import market for India. China has also become an important host for Indian FDIs, especially in software business. As for the rest of South Asia, China and Pakistan have initiated their FTA process, starting with an early harvest program. China has also become an observer of SAARC in 2005, while a liberalization package has also been introduced in the Asia-Pacific Agreement (formally the Bangkok Agreement).

Trade and investment between China and South Asia is rapidly growing, although the absolute size of this exchange is still rather limited. There are still too many tariff and non-tariff barriers between the two sides.

The following are the policy recommendations culled from this study.

VI.1 Bilateral Relations

1. China and India are the two largest and fast-growing developing countries in the world.. However, trade disputes have emerged and threatened to become serious because of the trade imbalances, and the increasing incidence of anti-dumping cases initiated by the Indian government against Chinese exports. In order to promote trade (both of goods and service) between the two countries, it is highly necessary to reduce the tariff and non-tariff barriers and improve overall governance. The two countries have agreed to study the possibility of a possible new-age FTA, which will cover a comprehensive package of economic cooperation and which could be opened to other South Asian countries as well.
2. China and Pakistan are traditional partners and their trade relations continue to develop, although compared with other South Asian countries, the growth of trade is rather modest. The deficit experienced by Pakistan is also worsening due to its limited export capacity to China. In order to improve the trade and investment environment between China and Pakistan, it is important to help to enhance the capacity of Pakistan companies exporting to China. The planned FTA between the two countries could be a step towards this direction. Negotiations should therefore be speeded up and aim to cover as many sectors as possible. China should offer more concessions to Pakistan and do more in capacity building for the country. The two sides should further expand their economic cooperation in the areas of energy and manufacturing through more FDI from China. The Pakistan government proposed to be an “energy corridor” and China shows strong interest to support and cooperate in this area. Chinese companies can expand their business in the special industrial zone which the two governments agreed to initiate in Pakistan. Pakistan should significantly improve its business (trade and investment) environment, especially the security environment.
3. Trade relations between China, Bangladesh and Sri Lanka have developed fast in recently years. But the trade deficit incurred by Bangladesh and Sri Lanka in their trade with China is worsening. This is mainly because of the similar export structure of Bangladesh and Sri Lanka products and the low export capacity of their enterprises. However, Chinese companies still complain that the tariff levels and in those two countries are still high, and there also many kinds of non-tariff taxes and fees. The financial systems of Bangladesh and Sri Lanka need to be improved. In recent years, many Chinese companies have invested in Bangladesh and Sri Lanka, either through FDI, or project contracts. However, the size is still limited. The three countries should strengthen their cooperation in improving business environment and initiate the feasibility studies on the FTAs. China should provide assistance to those two countries for enhancing their export capacity and economic development.

VI.2 Regional cooperation

China and South Asia have developed their economic relations under a regional framework. For instance, China became an observer of SAARC, which provides a venue to discuss the trade and investment facilitation programs, among others. However, political inertia could slow down the SAARC FTA process. Thus, China should explore other avenues to enhance its integration with the region.

The Bangkok Agreement initiated by UNESCAP in 1975 with 6 members (China, Bangladesh, India, Sri Lanka, Laos and Republic of Korea) from East and South Asia is one of the major arrangements that bring China (other East Asian countries) and South East Asian together. It was renamed as “ Asia-Pacific Trade Agreement” in 2005 and has since then implemented tariff reductions, which led to the lowering of the tariffs of about 4,000 items by about 30%.

China should continue to promote greater sub-regional cooperation with India, Myanmar and Bangladesh, which could be helpful for policy dialogue, improvement of infrastructure and development cooperation.

VI.3 Infrastructure

The land connection between China and South Asia is mostly found in the Southern and Southwestern provinces, especially Yunnan and Shuchuan. The current infrastructure is backward and is not able to support the increasing exchanges between China and South Asia. Four efforts should be made in order to improve the infrastructure:

-- China and Pakistan agreed to improve the existing Karakoram Highway that is the only road link between China's South and Western region to Pakistan. China and India may consider reconstruction of the Stilwell Road that was built during the Second World II linking China, Myanmar and India. The roads connect Yunnan-Myanmar-Sri Lanka (reach to Chittagong port) could also be placed on agenda.

-- The sea links are potentially more important than roads. China and South Asian countries should develop modern port networks.^[15]

--China and South Asian countries have increased their air links, but they are far from sufficient. Aside from arranging more passenger jet lines, the cargo lines should also be developed quickly.

[1] This paper is based on a joint research done by the team members of Dr. Zhao Jianglin, Dr. Li Shujuan, Dr. Li Wei, Dr. Lu Bo and Dr. Liu Xiaoxue.

[2] Hong Kong, Taiwan and Macau.

[3] Commercial Yearbook 2005, MOC.

[4] South Asia includes Bangladesh, India, Nepal, Pakistan, and Sri Lanka. East Asia includes ASEAN 10, Japan, Korea, as well as Hong Kong, Macao and Taiwan Province.

[5] Source: <http://www.szjtj.com/pub/szjtjpublic/tjgb/>; <http://www.stats.gov.cn/>; MOFCOM, PRC.

[6] If East Asia includes Hong Kong and Taiwan, China's total trade with the region grew from \$67.14 billion to \$654.69 billion, the export from \$39.95 billion to \$315.50 billion and the import from \$27.19 billion to \$339.18 billion, the respective average annual growth rates were 16.4%, 14.8% and 18.3%.

[7] Agreements with Hong Kong and Macao have some unique characteristics compared with that with ASEAN. First, Hong Kong and Macao do not have much original products and their gains are mainly in the concessions in trade in services provided by China, but such gains are not directly reflected in trade account. Secondly, these two partners are China's Special Administrative Regions and more preferences have been granted to them.

[8] For sensitive products tariff rates will be reduced to 20% by January 2012, and subsequently reduced to 0-5% by January 2018 (liberalization for Cambodia, Laos, Myanmar, Vietnam (CMLV) is delayed to 2015 and 2020, respectively). For Highly Sensitive products, tariff rates must not be more than 50% by January 2015 for ASEAN 6 and China, and January 2018 for the CMLV countries.

[9] China demands for the market economy status recognition from its FTA partners. In some cases, this has become a pre-condition in launching the FTA negotiations.

[10] All representatives shall be resident in China no less than six months each year. The representative office shall not employ Chinese national registered lawyers outside of China.

[11] China's Ministry of Communications, "The Current Status of China's Transport and Its Development Objectives During the 10th Five-Year Plan", March 29, 2001.

[12] All the statistics came from "2005 Road and Waterway Transportation Statistics Report" by China's Ministry of Communications.

[13] Stilwell Road (or, the Ledo Road) was built by the Americans in World War II and named after British commander General Joseph Warren Stilwell, chief of Staff of the Allied Forces. This 60 year old road connects Ledo in Assam to Kunming in China running through India (61 Kms),

Myanmar (1033 Kms) and China (632 Kms). At present, most of the trade between Yunnan and India follow the shipping way, with total length of more than 6000 km. If with the help of the road, the distance from Yunnan province of China to India could be reduced to 1220 km, much less than the shipping way. However, the Stilwell Road is in a state of disrepair right now. Thus, Yunnan province actively supports reviving this road link to South Asia. It has begun to upgrade the part of the road locating within its territory. But reviving Stilwell Road also needs strong political will much more than physical repairs. It has to take some time in confidence building among India, Myanmar and China, so that they can make their decision and cooperate in rebuild the road.

[14] On November 23, 2003, the State Council issued the Import and Export Duty Statute for the purpose of readjusting and improving the customs valuation system. In addition, a series of capacity building measures were also undertaken, including translation and publishing of the Customs Valuation Agreement and other important documents in Chinese, research and introduction of the best international customs management practices etc.

[15] It would be feasible to connect China-South East Asia-South Asian ports, and also it is necessary to develop road-port links.