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China's plan to reshape world trade

Friction with the west has prompted Beijing to build an alternative architecture focused on developing nations and insulated from the US — reflecting anxiety about the withering of the global trading system.By James Kynge and Keith Fray

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Even during the first blush of the honeymoon period that attended China's accession to the World Trade Organization in 2001, it was clear that Washington and Beijing were — as a Chinese idiom has it — "sharing a bed but dreaming different dreams".

Bill Clinton, the then US president, hailed China's membership as "removing [Beijing's] government from vast areas of people's lives" and promoting political reform. Jiang Zemin, China's then leader, had a different take. He warned that America's real motive was to "westernise and divide socialist countries". More than 20 years later, that early friction has metastasised. The WTO — which holds its biennial ministerial conference this week — has fallen hostage to sharp divisions between the US and China as trade friction escalates between China and the west.

As the world trade body falters, China is accelerating efforts to construct an alternative trade architecture that is insulated from US influence and centred upon the developing world.

In this, Beijing's main strategy is to capitalise on ties with the "global south" fostered through its $1tn Belt and Road Initiative (BRI), an investment programme launched in 2013 that counts more than 140 countries in Asia, Africa, Latin America and elsewhere as its participants. The architecture under construction revolves around a China-centric network of bilateral and regional "free trade agreements" (FTAs), which allow for trade at low tariffs while also promoting direct investment flows, Chinese officials and trade experts say.

This network — which currently includes 28 countries and territories that take close to 40 per cent of China's exports — means that if the WTO's mandate to keep the world open for liberalised trade unravels, China will have at least a partial back-up system in place, they add. None of China's FTAs include the US or countries inside the EU.

"China felt that it needed to construct an alternative system serving its own interests," says Henry Gao, professor of law at Singapore Management University and an adviser to the WTO. "This alternative is mainly based on the BRI, to which China is progressively trying to shift its exports from traditional markets like the US and EU," Gao adds.

China's push to protect its trade reflects its anxiety about the withering of the post-second world war global trading system, a threat that has intensified since 2018, when then US president Donald Trump slapped hefty tariffs on trade with China. Global trade values are predicted to have shrunk by 5 per cent last year as the number of "traderestrictive measures" — which includes tariffs and non-tariff measures — rose significantly, according to Unctad, a UN development body.

The main headwind for the global trading system has come in the form of a breakdown of the WTO's dispute resolution system since 2019. The dysfunction of the WTO's appellate body — the top appeals court for world trade — has meant that many multibillion-dollar trade disputes sit in legal limbo, making commerce more costly and complex.

Most analysts do not foresee drastic scenarios such as the demise of the WTO. But some say that the multiple challenges that the organisation faces — including hefty industrial subsidies in several large trading nations and the establishment of parallel FTA architectures such as the one China is building — could undermine it significantly.

"Multiple threats suggest that the future for the WTO is far from assured, even if a sudden collapse or departure of a critical player is unlikely," wrote Mark Linscott, a former assistant US trade representative. "If [the industrial policies] persist, the WTO's rule of law could collapse," he added.

S igning bilateral and regional FTAs is a priority of Xi Jinping, China's authoritarian leader. "China will strive to build a more open and inclusive environment for development," Xi said in a speech last September. "China will expand the globally-oriented network of high-standard free trade areas," he added.

A Chinese trade official, who declined to be named, puts it more forcefully**. "China plays the leading role in free trade while the US and EU are becoming more protectionist," the official says. "We need to speed up the number of free trade agreements we sign and also assure the quality of these agreements in order to create sufficient room for China's development."**

Calculations by the FT reveal significant progress. China's merchandise exports to all countries and territories covered by its FTA network comprised about 38 per cent of its worldwide exports in the 12 months to the end of October last year. Given that over this period, China — as by far the world's biggest exporter — shipped some $3.43tn around the world, its FTA network took roughly $1.3tn of that total.

To put the size of this FTA footprint into context, China exports more to its FTA network than the world's fourth and fifth-biggest exporters, the Netherlands and Japan, did all over the world during 2022.

The establishment of China's FTA ecosystem gained impetus after the 2008 financial crisis instilled a deep sense of anxiety in Beijing over the stability of the world's economy.

A China-Singapore FTA in late 2008 was followed in 2010 by a China-Asean FTA with all 10 countries that make up the south-east Asian economic grouping. But it was after the US excluded China from talks to join the Trans-Pacific Partnership, a big multilateral trade deal that was signed in 2016, that Beijing really threw its FTA programme into overdrive. Its biggest success to date has been negotiating membership of **the 15-country Regional Comprehensive Economic Partnership,** a huge regional FTA that went into force in 2022. The members of the **RCEP** contribute around **one-third of the world's GDP.**

But Beijing is not stopping with the RCEP. It is currently negotiating 10 FTAs which, not including those that are upgrades of FTAs already in force, would account for around a further 4.3 per cent of its global exports, according to FT calculations. Meanwhile, feasibility studies are also under way for eight other FTAs which, if concluded, would account for roughly a further 2.6 per cent of Chinese exports to the world.

Over the longer term, Beijing's focus will be on pivoting its trade further towards the developing world by using its ties with the more than 140 countries covered by the BRI and signing FTAs with them where possible, Chinese experts say.

This trend is well under way, says Gao, adding that China's exports to the 10 member countries of Asean — all of which are included in the BRI — exceeded exports to the US in the year to October 2023. More broadly, China's trade with the BRI countries exceeded that with the US, EU and Japan together.

Michael Power, an emerging markets expert at Ninety One, an asset manager, sees China's commercial engagement with developing nations as evidence the world is tilting on its axis. "China is not just trying to create an alternative world order. **It is succeeding**," says Power. "Many in the west cannot gauge the success China is having in the rest of the world.

"As the west sets about decoupling from China, the rest of the world is reorientating itself towards China," he adds.

One expression of the changes under way lies in an upsurge in investment flows that are following the topography of Chinese FTAs. Direct Chinese investment into Asean, which climbed to $15.4bn in 2022 from the $9bn invested in 2019 prior to the pandemic, is helping to transform the region's economic destiny, Power says.

High-tech manufacturing hotspots such as Penang in Malaysia for semiconductors and Kalimantan in Indonesia for electric vehicles and EV batteries are just two examples of Asean countries climbing the technology ladder.

To a marked degree, China's FTA outreach follows its geopolitical imperatives. One priority is a proposed FTA with the **Gulf Cooperation Council (GCC),** a union of the Arab states Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. This FTA has undergone 10 rounds of negotiation and was said by Chinese officials in 2022 to be in its "final and critical stage".

The GCC represents a vital strategic interest for China. Not only did China export $112.5bn to the region in the 12 months ending in October last year, it also relies on the fossil fuel exporters in the region for about 40 per cent of its oil imports. Beyond that, Chinese tech companies such as Huawei, a telecoms giant sanctioned by the US, have helped install basic infrastructure in several GCC countries.

Another big prize that China is eyeing is **the African continent**, say Chinese officials, who did not want to be identified. The 2018 establishment of the African Continent Free Trade Agreement (AfCFTA), which 54 African countries have signed, creates a huge opportunity for China.

Although Beijing has not stated a desire to join the AfCFTA, China's status as the continent's biggest national trade partner has driven a close alignment with the grouping. It funds support for the AfCFTA's secretariat and, in 2021, China's ministry of commerce signed an agreement to establish an expert group at the AfCFTA to collaborate on questions such as digital trade, customs procedures and intellectual property rights, according to Chinese officials.

C hina does not wish to see the demise of globalisation as represented by the WTO. On the contrary, Beijing has been a clear beneficiary of trade liberalisation over more than two decades, enjoying more than a 10-fold increase in its total trade since its 2001 accession to the word trade body, vastly outstripping the global average by several times.

But in spite of all the effort that Beijing has expended in building its alternative trade architecture, the current escalation of trade friction with both the US and EU means that China remains gravely exposed to risks that global trade values could retreat further from 2023 levels.

"China's expanding network of bilateral FTAs and RCEP **cannot effectively insulate China from the trade friction building with the US and the EU,"** says Zongyuan Zoe Liu, an expert at the Council on Foreign Relations, a New York-based think-tank.

"Trade loss due to tensions with the US and EU cannot easily be supplemented by trading with other countries and regions, as evidenced by China's trade shrinkage in 2023," she adds.

Thus the storm clouds building over the west's trade with China are of great concern to Beijing. As so often in the past, the main sticking point is the industrial subsidies that US and EU officials say China has lavished upon some advanced manufacturing sectors, creating unfair cost advantages for Chinese companies.

Washington this month warned Beijing that the US and its allies would take action if China tried to ease its industrial overcapacity problem by dumping goods on international markets, according to American officials.

The topic will be a "major part" of the agenda when Janet Yellen, the US Treasury secretary, visits Beijing later this year, one US official adds. Yellen is also expected to raise Chinese overcapacity with her G20 counterparts when they meet in São Paulo this week. During the administration of Donald Trump, which ended in 2021, the US imposed tariffs on some $300bn in Chinese exports.

EU competition commissioner Margrethe Vestager said this month the bloc was "absolutely willing to use" trade tools to tackle unfair Chinese trade practices. Her remarks reinforce comments last year from Ursula von der Leyen, president of the European Commission, that global markets are "flooded" with Chinese electric cars that are kept artificially cheap by "huge state subsidies".

Beijing, for its part, has launched an anti-dumping investigation into brandy imported from the EU, a measure which could affect $1.57bn of spirits, almost all of which is made in France.

With so much uncertainty hanging over the future, Chinese companies are taking pre-emptive measures to skirt whatever trade altercations are coming their way.

Chinese companies are seeking to circumvent US and EU tariffs in a number of ways. One of these is transshipment, a method that is fully on display in Mexico, which as a member of North American Free Trade Agreement (Nafta) can export goods to the US market at much lower tariffs than China can access.

Another trend is for "**nearshoring"** — or the relocation of production capacity closer to customers to limit vulnerability to geopolitical tensions — which is reconstituting China's global footprint. Chinese direct investment flows into Malaysia, Indonesia and other countries seen as useful "nearshoring" countries have been on the rise.

But even here, Chinese investors are not necessarily safe. "China's FTAs can facilitate Chinese companies to set up factories and manufacturing plants in foreign countries to eventually export to the US and EU," says Liu.

"But if laws in the US and EU change to include additional restrictions on Chinese ownership of factories outside of China, Chinese factory migration may eventually prove to be not as effective," she adds.

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Figure(s):

Xi Jinping, China's president, has made signing bilateral and regional free trade agreements a priority FT montage/Getty