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## The impact of free trade agreements on business activity: A survey of firms in the People's Republic of China

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## **ADB Working Paper Series**

### **The Impact of Free Trade Agreements on Business Activity: A Survey of Firms in the People's Republic of China**

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**Yunling Zhang**

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**Abstract**

The People's Republic of China (PRC) has emerged as a major player in the global economy and considers free trade agreements (FTAs) an important part of its global trading strategy. The PRC's export industries are embedded in existing regional and global production networks and are reliant on foreign direct investment flows and external supplies of material and intermediate goods. Immediately after its accession to the World Trade Organization in December 2001, the PRC adopted a regional approach to trade and began negotiating and implementing FTAs. This paper analyzes the results of a survey undertaken across 232 Chinese firms with regard to FTA-related issues such as utilization, perceived costs and benefits, perceptions of multiple rules of origin, and policy and institutional support mechanisms. It was found that, of the firms surveyed, 45% were using FTAs to some extent. While this utilization rate appears relatively high, and reflects the assertive stance of Chinese firms when it comes to exploring market opportunities, the actual coverage of export value by FTAs is variable. In general, Chinese firms view FTAs as a way to increase their access to partner markets. Nevertheless, there remains an orientation toward the United States and other traditional markets. However, over time, as rebalancing of growth takes place, there may be a shift in market orientation toward the Association of Southeast Asian Nations (ASEAN) and regional markets and the use of FTAs may intensify. This study offers several proposals to increase FTA use, including the expansion of support services for firms, the promotion of larger regional FTAs, and the creation of more opportunities for collaboration between the government and the private sector.

**JEL Classification:** F1, F15, O24

## Contents

1.	The People's Republic of China's Free Trade Agreement Strategy.....	1
1.1	Introduction.....	1
1.2	The ASEAN-PRC CECA .....	3
1.3	Future FTA Trends .....	4
1.4	The Impact of FTAs on Trade .....	5
2.	Analysis of Survey Data .....	7
2.1	About the Survey .....	7
2.2	Sample Profile .....	8
2.3	FTA Use .....	14
2.4	Impediments to Use .....	16
2.5	Costs and Benefits of Selected FTAs.....	17
2.6	Business Responses to FTAs .....	19
2.7	Rules of Origin.....	20
2.8	FTA Policy Issues and Institutional Support.....	23
3.	Conclusion.....	26
3.1	Concluding Points .....	26
3.2	Policy Recommendations.....	27
	References.....	29

# 1. THE PEOPLE'S REPUBLIC OF CHINA'S FREE TRADE AGREEMENT STRATEGY

## 1.1 Introduction

Immediately after its accession to the World Trade Organization (WTO) in December 2001, the People's Republic of China (PRC) adopted a regional trade strategy. The PRC has concluded six free trade agreements (FTAs) and two closer economic partnership arrangements (CEPAs) as of the beginning of 2010, namely, the ASEAN-PRC Closer Economic Cooperation Agreement (CECA) (goods and services); the PRC-Pakistan FTA; the PRC-Chile FTA (goods and services); the PRC-New Zealand FTA; the PRC-Singapore FTA; the PRC-Peru FTA; the PRC-Hong Kong, China CEPA; and the PRC-Macao CEPA (see Table 1 for a summary of the status of PRC trade agreements). Further, the PRC has conducted negotiations with the Gulf Cooperation Council<sup>1</sup> (GCC), Australia, Iceland, and Norway; a Track 1 study on PRC-Costa Rica; and Track 2 studies on PRC-South African Customs Union<sup>2</sup>, PRC-India, and PRC-Republic of Korea (hereafter Korea). With regard to these bilateral FTAs, both developing and developed economy partners come together with the PRC on the basis of mutual interest. The PRC insists that negotiations incorporate official recognition of its status as a market economy.

In terms of regional agreements, the PRC is a signatory to the Asia-Pacific Trade Agreement (tariff reduction only, incorporating India, Korea, Bangladesh, Sri Lanka, the Lao People's Democratic Republic [Lao PDR], and the PRC) and the Greater Mekong Sub-Region Cross-Border Transport Agreement (GMS Agreement), and it has participated in Track 2 studies on the PRC-Japan-Korea (CJK) FTA, the ASEAN+3<sup>3</sup> FTA (East Asian Free Trade Agreement [EAFTA]), and the Comprehensive Economic Partnership in East Asia (CEPEA)<sup>4</sup>.

In general, the PRC has adopted a gradual approach when negotiating agreements with trading partners: first goods, then services and investment, followed up by a comprehensive FTA package subject to the agreement of both parties. The ASEAN-PRC CECA and the PRC-Chile FTA were both adopted via this gradual approach. The PRC-Pakistan FTA was preceded by an early harvest program (EHP) based on tariff reductions, after which further negotiations around goods and investment took place (Zhang 2009a). In contrast, the PRC-New Zealand, PRC-Singapore, and PRC-Peru FTAs were all comprehensive and single packaged agreements (Zhang 2009b).

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<sup>1</sup> Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

<sup>2</sup> Botswana, Lesotho, Namibia, South Africa, and Swaziland.

<sup>3</sup> Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Viet Nam + the PRC, Japan, and Korea.

<sup>4</sup> Amongst ASEAN+6, consisting of ASEAN+3 (see footnote 4) + Australia, New Zealand, and India.

**Table 1: The Status of PRC Involvement in FTAs**

Status	Agreement	Remarks
Signed or In Effect	Asia-Pacific Trade Agreement (1976)	In effect since 1976; PRC acceded in 2001
	PRC-Thailand PTA (2003)	Early Harvest Program of ASEAN-PRC CECA
	PRC-Hong Kong, China CEPA (2004)	
	PRC-Macau, China CEPA (2004)	
	ASEAN-PRC CECA (2005)	Framework agreement signed in 2002; TIG agreement in effect since 2005; TIS agreement in effect since 2007
	PRC-Chile FTA (2006)	
	PRC-Pakistan FTA (2007)	
	PRC-New Zealand FTA (2008)	
	PRC-Singapore FTA (2009)	
Under Negotiation	PRC-Peru FTA	Signed in 2009; expected to take effect soon
	PRC-GCC FTA (2005)	Framework agreement signed in 2004; under negotiation
	PRC-Australia FTA (2005)	
	PRC-Iceland FTA (2006)	
	PRC-Norway FTA (2007)	
Proposed	PRC-Costa Rica FTA (2009)	
	PRC-India FTA (2003)	
	PRC-Japan-Korea FTA (2003)	Investment agreement initiated in 2007
	EAFTA (ASEAN+3) (2004)	Initiated study in 2004; report completed in 2006
	PRC-SACU FTA (2004)	
	PRC-Korea FTA (2005)	
	FTAAP (2006)	
	CEPEA (ASEAN+6) (2007)	
	PRC-Switzerland FTA (2009)	

ASEAN = Association of Southeast Asian Nations; CECA = comprehensive economic cooperation agreement; CEPA = comprehensive economic partnership agreement; CEPEA = Comprehensive Economic Partnership for East Asia; EAFTA = East Asian Free Trade Agreement; EFTA = European Free Trade Association; EHP = Early Harvest Program; EPA = economic partnership agreement; FTA = free trade agreement; FTAAP = Free Trade Area of the Asia-Pacific; GCC = Gulf Cooperation Council; Korea = Republic of Korea; PRC = People's Republic of China; PTA = preferential trade agreement; SACU = Southern African Customs Union; TIG = trade in goods; TIS = trade in services

Note: The PRC-Singapore and PRC-Peru FTAs do not form part of this study as both agreements were concluded after the interviews took place. Years in brackets following the agreement name indicate either the year of signing, the year in which negotiations commenced, or the year the agreement was proposed depending on the current status of the agreement.

Source: Ministry of Commerce of the People's Republic of China (2009) and Asian Development Bank (2010), data as of February 2010.

Due to their focus on market liberalization and the facilitation of trade, FTAs between the PRC and developing economies tend to center upon the reduction of tariffs and non-tariff barriers to trade. However, agreements with developed economy partners, such as the PRC-New Zealand and PRC-Singapore FTAs, extend to incorporate other policy and institutional issues, for example, intellectual property rights, transparency measures, quality assurance standards, and competition policy etc.

## 1.2 The ASEAN-PRC CECA

The PRC launched its regional trade strategy with the ASEAN-PRC CECA. This starting point was chosen primarily for pragmatic reasons and reflects an “easier first” approach. In many ways the ASEAN-PRC CECA was a natural extension of the increasing interest in trade and economic relations shared by the parties. From the PRC’s perspective, an FTA would make it easier for Chinese companies to enter ASEAN markets. Further, an FTA would also serve as a preliminary experiment in the promotion of regional integration and cooperation. Politically speaking, the PRC was more confident entering into an FTA with ASEAN partners than it was with, say, Japan or Korea.<sup>5</sup>

In consideration of the internal differences among ASEAN member states, liberalization has been undertaken through two separate tracks with different timetables for trade in goods and trade in services (Tables 3 and 4).

**Table 3: ASEAN-PRC CECA for Trade in Goods (entered into force July 2005)**

I.	Principles to be incorporated into agreement:
	(1) EHP
	(2) Tariff reduction: gradual, with timetable, two separate tracks for old and new ASEAN members
	(3) ROO accumulation, VC 40% <sup>a</sup>
	(4) Trade dispute settlement
II.	Liberalization measures:
	(1) EHP: 600 agricultural products to have zero tariffs (staged introductions in 2006 and 2009)
	(2) Normal track: 93% of products to have zero tariffs (staged introductions in 2010 [new members 2015] and 2012 [new members 2018])
	(3) Sensitive track: tariffs reduced to 0–5% by 2018 for ASEAN-6 and PRC and by 2020 for CMLV; Highly sensitive track: tariff rate reduced to below 50% by 2015 for ASEAN-6 and PRC and by 2018 for CMLV.

ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand; CECA = closer economic cooperation agreement; CMLV = Cambodia, Myanmar, Lao PDR, and Viet Nam; EHP = early harvest program; EPA = economic partnership agreement; ROO = rules of origin; VC = value content; PRC = People’s Republic of China

<sup>a</sup> Rules of Origin (ROOs) refer to the set of criteria used to determine the country or customs territory of origin of a product. Value content (VC) refers to the share of a product that must originate from an FTA member country or economy in order for that product to qualify as originating from that member country or economy

Source: Ministry of Commerce of the People’s Republic of China (2009).

With regard to the liberalization of services, the commitments of signatories to the ASEAN-PRC CECA were far more extensive than those made in the WTO (however, for new ASEAN members these did not exceed WTO commitments). The services liberalization agenda was negotiated one year after the implementation of the agreement for trade in goods. However, there were several sectors excluded from this agenda and even within the liberalized sectors many areas remain outside of the agreement.

<sup>5</sup> Political gains are also important for the PRC. Since a closer economic relationship helps to smooth the comprehensive relations between partners, this can have a significant effect in creating a surrounding peaceful environment.



**Table 4: ASEAN-PRC CECA for Trade in Services  
(entered into force July 2007)**

I.	Principles/features to be incorporated into agreement: (1) The PRC makes a single schedule of specific commitments, while each ASEAN member country makes an individual schedule of specific commitments (2) Consistency with WTO rules (3) National treatment for signatories' products/firms in partner markets (4) Progressive liberalization; review of existing agreements and initiation of new negotiations; flexibility and capacity building for CMLV (5) Dispute settlement mechanism (6) Emergency safeguard measures
II.	PRC's liberalization commitment areas (with exceptions and limitations): (1) Computer and related services (2) Real estate services (3) Business services: market research services, management consulting services, services related to management (4) Construction and related engineering services (5) Environmental services (excluding environmental quality monitoring and pollution source inspection) (6) Recreational, cultural, and sporting services (excluding audiovisual services, golf) (7) Transport services: aircraft repair and maintenance services (joint ventures), computer reservation system services (cooperation with PRC services) (8) Road transport services (including maintenance and repair services for motor vehicles)
III.	Exclusions: (1) Financial services (2) Government procurement (3) Air services

ASEAN = Association of Southeast Asian Nations; CECA = closer economic cooperation agreement; CMLV = Cambodia, Myanmar, Lao PDR, and Viet Nam; PRC = People's Republic of China

Source: Ministry of Commerce of the People's Republic of China (2009).

The ASEAN-PRC CECA is just one core component of a more comprehensive framework agreement that lists other areas for broad cooperation. The five areas emphasized as priority sectors for cooperation are agriculture, information and communications technology, human resources development, investment, and the Greater Mekong Sub-Region (GMS). Within and beyond these areas, cooperation has taken place in relation to banking, finance, tourism, industry, transport, telecommunications, intellectual property rights, small and medium enterprises (SMEs), the environment, bio-technology, fisheries, forests and forestry products, mining, energy, and sub-regional development. Capacity building programs have been implemented and technical assistance provided, particularly for the newer ASEAN member states, to facilitate economic structural adjustment and expand trade and investment with the PRC. A profoundly significant aspect of the economic integration between the PRC and ASEAN has been the establishment of legally-based systems for trade, investment, and management that follow WTO rules and international standards (Banda and Whalley 2005).

### 1.3 Future FTA Trends

The PRC will continue its efforts to conclude more FTAs into the future. The most likely FTAs to be concluded in the near future are the PRC-GCC, PRC-Norway, PRC-Costa Rica, and PRC-Australia FTAs. The region that has the greatest significance for the PRC, however, is East Asia. The PRC has expended great effort in promoting East Asian regional cooperation and integration. Economically, the PRC is a key player in the East Asian regional production network and it has benefited remarkably from increased integration and cooperation. For this reason, the PRC will continue to initiate and participate in further regional arrangements. Apart from the ASEAN-PRC CECA, the PRC also has a strong

interest in promoting the EAFTA. The primary reason for this is that a substantial amount of economic integration (in the form of a regional production network) already exists among East Asian economies. The PRC is also promoting a PRC-Japan-Korea FTA (also known as the CJK FTA) in northeast Asia (Korea Institute for International Economic Policy 2008). These three economies are among the most integrated in East Asia and have, through foreign direct investment (FDI), created a high-level economic network that facilitates economic exchange in trade, services, and other activities. The PRC is the largest export market for both Japan and Korea and the largest and second largest market for FDI for Korea and Japan respectively. For its part, the PRC believes that a CJK FTA would expand its market access to both partner economies. Track 2 studies for the CJK FTA have been underway for several years and indicate that each of the three economies would benefit significantly from its implementation. While it has been difficult for the three parties to reach a political consensus, each agrees that an investment agreement should be negotiated first, with a view to establishing a solid foundation for future negotiations around the trade of goods and services as well as further economic cooperation.<sup>6</sup>

The Free Trade Area of the Asia-Pacific (FTAAP) initiative was proposed by the United States during the Asia-Pacific Economic Cooperation (APEC) leaders' meeting in 2006. Although the PRC considers the negotiation of an FTA in such a large region as the Asia-Pacific to be premature, it has actively participated in APEC activities.

There are other factors beyond the interests of the PRC that also have an impact on the speed at which negotiations for new FTAs may proceed. Negotiations may be restrained by prospective partners placing less priority on FTAs as an economic development strategy, by the constraints of partners' domestic social pressures (particularly with regard to the liberalization of their agricultural sectors), and/or by potential partners' general concerns about the effects of increased competition.

## 1.4 The Impact of FTAs on Trade

FTAs usually promote trade in goods and services and investment by creating an improved environment for business between the partners (Kawai and Wignajara 2008). For example, the EHP between the PRC and ASEAN helped to increase the volume of agricultural trade between signatories. In the case of the PRC-Thailand EHP, the PRC share in Thai agricultural exports rose from 8.8% in 2003 to 13.4% in 2006. Trade in goods between PRC and ASEAN has increased significantly over the past decade, with an average annual growth rate of over 20% since 2000 (Ministry of Commerce of the PRC 2009). However, it is debatable whether the growth since 2005 is entirely attributable to the FTA, given the extrinsic fact of the PRC's economic boom and the increasingly integrated regional production network naturally deriving from increased flows of FDI between the PRC and ASEAN during that period (Hong 2008). The PRC's imports from ASEAN have increased at a faster rate than its exports to the region. In 2009, ASEAN was the third largest import market for the PRC. Strikingly, "high tech goods" (mainly electronics parts and automobiles) accounted for 53% of the PRC's imports from ASEAN in 2009.

Even though the implementation of the FTA may have assisted in the development of the region's production network (propelled by FDI between the PRC and ASEAN), this assumption should be made with caution if the only evidence used to support it are post-FTA growth rates of trade in goods between the PRC and ASEAN. For example, the growth rate of trade in goods, although high overall, was lower in 2005–2006 (after implementation of the FTA) than in 2003–2004 (before implementation).

FTAs may, theoretically, also prompt diversion of trade and investment away from countries with less favorable business conditions. However, these effects are not obvious in the case

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<sup>6</sup> Japan seems in no hurry to pursue the CJK FTA and has placed it on its long term agenda. See Zhang and Xu (2008) for more information.

of the ASEAN-PRC, ASEAN-Japan, and ASEAN-Korea agreements, in which three independent ASEAN-plus FTAs essentially compete with one another. Further, trade and investment activities among the PRC, Japan, and Korea also seem to have been unaffected by the three ASEAN-plus FTAs. The primary element affecting trade and investment among ASEAN+3 countries is their differently structured domestic markets and economies. Considering the large investments coming from Japan and Korea to both ASEAN and the PRC, Japan and Korea may actually benefit from the ASEAN-PRC CECA because it creates a more open market for the existing production network.

Trade within East Asia is generally dominated by vertically-integrated production. Large volumes of trade and investment in East Asia simply follow the three “ASEAN-plus” routes, i.e., ASEAN-PRC CECA, ASEAN-Japan CEPA, and ASEAN-Korea CECA. Flows that cross these “ASEAN+1” routes are limited (except in the case of PRC-Japan-Korea). In practice, the major factors affecting flows of goods, services, and investment within East Asia are government policies (affecting the business policy environment), transportation infrastructure (affecting operation costs), and market sizes (affecting final sales volumes). The large trade flows between ASEAN-PRC, ASEAN-Japan, and ASEAN-Korea have not been greatly affected by the reduction in tariffs brought on by the FTAs, given that tariff rates were already very low—the weighted average tariff rate was less than 5% and there were no tariffs for manufacturing parts. Notably, information technology products were also already tariff free as a result of the WTO Information Technology Agreement.

**Table 5: Growth Rates of PRC Trade with Major Partners (% , year-on-year)**

Trade Partner	2002	2003	2004	2005	2006	2007
ASEAN Total	31.1	42.8	35.3	23.1	23.4	25.9
Exports	22.3	31.1	38.7	29.1	28.8	32.0
Imports	34.4	51.7	33.1	19.0	19.4	21.0
Japan Total	16.2	31.1	25.7	9.9	12.5	13.8
Exports	7.8	22.7	23.7	14.3	9.1	11.4
Imports	25.0	38.7	27.3	6.5	15.2	15.8
Korea Total	22.8	43.3	42.5	24.3	20.0	19.1
Exports	23.8	29.4	38.4	26.2	26.8	26.1
Imports	22.2	51.0	44.3	23.4	16.9	15.6
US Total	20.8	30.0	34.3	24.8	23.9	15.0
Exports	28.9	32.2	35.1	30.4	25.5	14.4
Imports	3.9	24.3	31.9	9.1	19.2	17.2
EU Total	15.4	44.1	33.9	22.6	26.0	27.0
Exports	20.3	49.7	38.8	34.1	30.0	29.1
Imports	10.4	37.7	27.8	5.0	19.1	22.4

ASEAN = Association of Southeast Asian Nations; EU = European Union; Korea = Republic of Korea; PRC = People's Republic of China; US = United States.

Source: International Monetary Fund (2009), data as of February 2009.

Nevertheless, the effects of the rules of origin (ROOs) attached to FTAs should be considered. Under the ASEAN-PRC CECA, a 40% value content (VC) accumulated ROO has been adopted for most goods. However, with the emergence of other FTAs, the complexity and added costs associated with ROO documentation could become a problem. For different FTAs, different ROO systems and requirements exist. A single product could be required to satisfy the different ROO requirements contained in multiple FTAs, depending on

the locations of different production processes. In fact, in the ASEAN-PRC CECA alone, three systems of ROO (i.e., VC, change of tariff classification, and product specific process) are adopted (though for most goods the 40% VC system is used). While it is not difficult for products to meet the requirements of the VC system, the associated documentation is very complex (Cheong and Cho 2006).

## 2. ANALYSIS OF SURVEY DATA

### 2.1 About the Survey

In October–December 2008, a survey of the business community of the People's Republic of China (PRC) was undertaken in order to investigate the actual and perceived effects of FTAs on export businesses. Rather than send questionnaires to firms, this survey was conducted through face-to-face interviews. Based on a pre-interview study of Chinese export firms, 232 companies were finally selected for this survey. The selected companies range across the PRC's 15 provinces and major cities (see Table 6).

**Table 6: Locations of Firms Surveyed**

Location	Number
Shanghai	20
Tianjin	27
Guangdong	30
Shandong	28
Zhejiang	15
Fujian (Xiamen)	20
Liaoning (Dalian)	10
Jiangsu (Nanjing)	10
Yunnan (Kunming)	10
Guangxi (Nanning)	10
Henan	12
Hubei (Wuhan)	10
Hunan (Changsha)	10
Shanxi (Xian)	10
Sichuan	10
<b>Total</b>	<b>232</b>

The selection of companies was based upon three factors: (i) size—including small, medium, and large sized firms, (ii) type of ownership—including privately-owned, joint venture, wholly foreign-owned, and state-owned firms, and (iii) type of exports—the main products produced by the firms for export to FTA partners. The survey questions were formulated to cover five major areas: (i) general firm background, (ii) preferences for the use of FTAs, (iii) perceptions of the impacts of FTAs, (iv) effects of rules of origin in FTAs, and (v) FTA policy issues and institutional support, as well as a further 17 sub-items.

The remainder of this paper is based upon an analysis of the data gathered via the interviews. It is divided into six sections, one for each of the five major question areas outlined in the previous paragraph and a final section incorporating concluding statements and policy recommendations. Due to the comprehensive coverage of the survey, in terms of firm sizes, locations, and business features, the report provides a rich source of useful information on the real effects of FTAs and the concerns and needs of the PRC's business community with regard to FTAs.

## 2.2 Sample Profile

### 2.2.1 Sector, Ownership, Firm Size, and Age

The 232 firms that comprised the survey sample were operating in five main sectors, namely, electronic goods and components, textiles and garments, automobiles and auto parts, machinery, and other sectors (see Table 7 for the sector composition and distribution of the survey sample by firm size and ownership).

**Table 7: Sample Profile**

	Sector					Size <sup>a</sup>			Ownership
	Electronics	Auto	Textiles/ Garments	Machinery	Other	SME	Large	Giant	Foreign
Number of firms (n=232)	45	29	39	55	64	41	90	92	91
Share of Total (%)	19.6	12.7	16.9	23.5	27.3	18.4	40.4	41.3	39.2

SME = small and medium enterprise.

Notes: Foreign firms are defined as firms with at least 10% foreign equity share.

Size is by number of employees: SME = 100 or fewer; large = 101–1,000; and giant = more than 1,000.

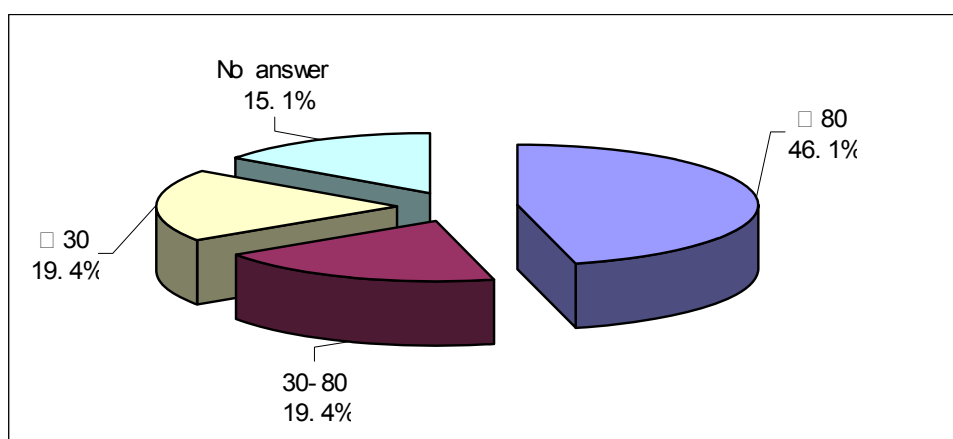
<sup>a</sup> Nine Chinese firms did not have data on number of employees.

Source: Author's computations based on the survey data.

With regard to type of ownership, foreign-owned enterprises accounted for 39.2% of the survey sample (91 firms) while domestic-owned enterprises accounted for 60.8% (141 firms), amongst which 19.9% were state-owned and 29.0% privately-owned.

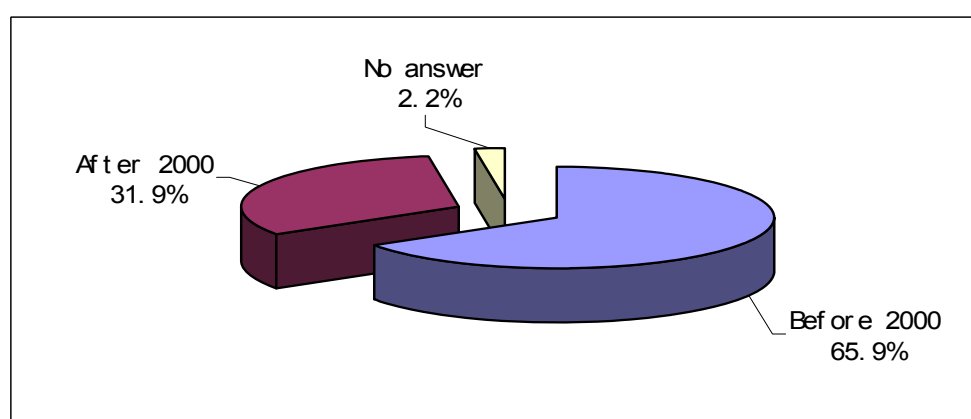
Calculated according to the number of permanent employees, large enterprises (101–1000 permanent employees) accounted for 40.4% of the survey sample, small and medium enterprises (100 or fewer permanent employees) for 18.4%, and giant enterprises (more than 1000 permanent employees) for 41.3%. Generally speaking, a larger firm will have both a higher capacity and more opportunities to export than a smaller firm and, therefore, a higher preference for FTAs. However, in many cases, small and medium firms may have a higher proportion of their products produced for export and enjoy better market access due to their specialized business relations with trade partners. Nevertheless, in general, small and medium size firms have a smaller comparative advantage in using FTAs.

Figure 1 indicates the breakdown of firm size amongst the survey sample as a function of the number of engineers and technicians employed. Of the survey sample, 46.1% of firms employed more than 80 engineers and technicians, 19.4% employed 30–80 engineers and technicians, while 19.4% had fewer than 30 engineers and technicians. This data is relevant because, generally speaking, the higher the number of engineers and technicians employed by a firm, the higher the firm's capacity for innovation and competitiveness.

**Figure 1: Number of Engineers and Technicians (% of sample firms)**

Source: Author's computations based on the survey data.

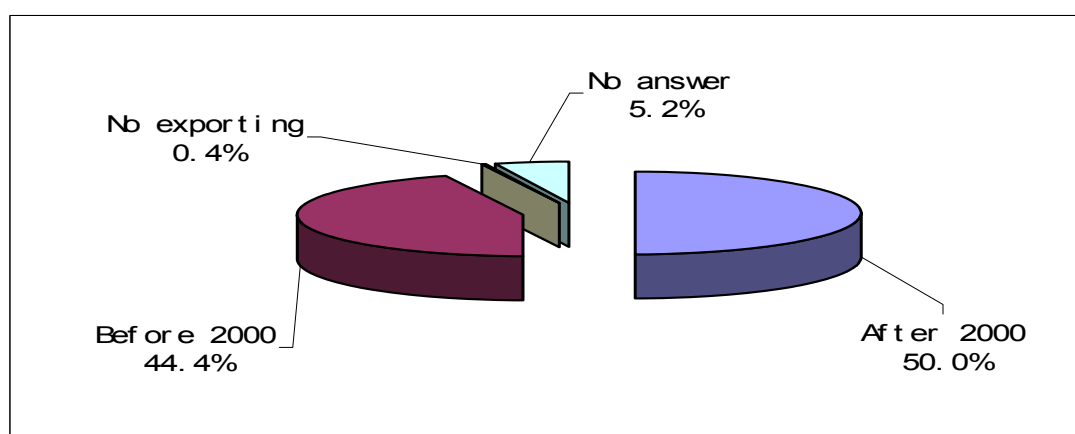
Figure 2 roughly indicates the maturity of the firms surveyed as a function of their year of establishment. Of the survey sample, 65.9% of firms were established before the year 2000, while 31.9% were established after the year 2000.

**Figure 2: Firm Year of Establishment (% of sample firms)**

Source: Author's computations based on the survey data.

## 2.2.2 Export Features

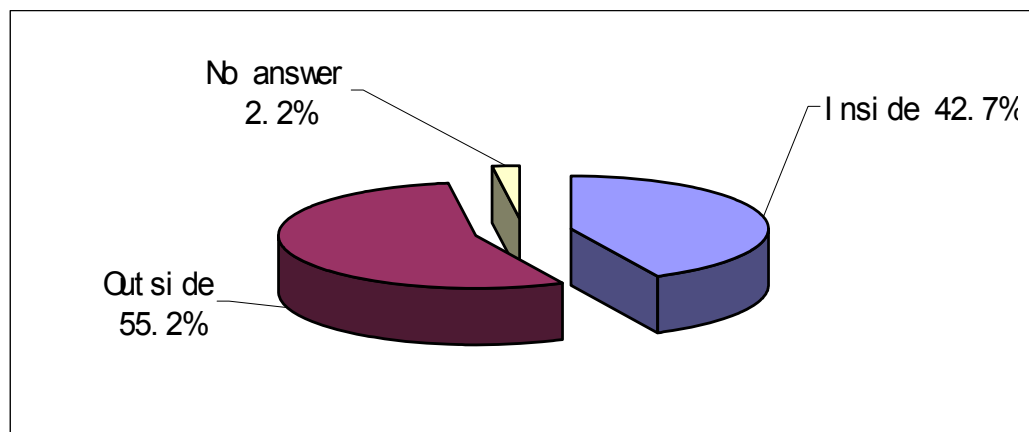
As shown in Figure 3, 50.0% of the firms surveyed starting exporting after the year 2000, while 44.4% started exporting before the year 2000.

**Figure 3: Year of Commencement of Export Operations (% of sample firms)**

Source: Author's computations based on the survey data.

In order to attract FDI and increase exports, the PRC has established many export processing zones (EPZs) along coastal areas.<sup>7</sup> Among the firms surveyed, 42.7% were located in the EPZs. Accordingly, more than half of the firms were located outside the EPZ areas (Figure 4).

**Figure 4: Firms in Export Processing Zones (% of sample firms)**

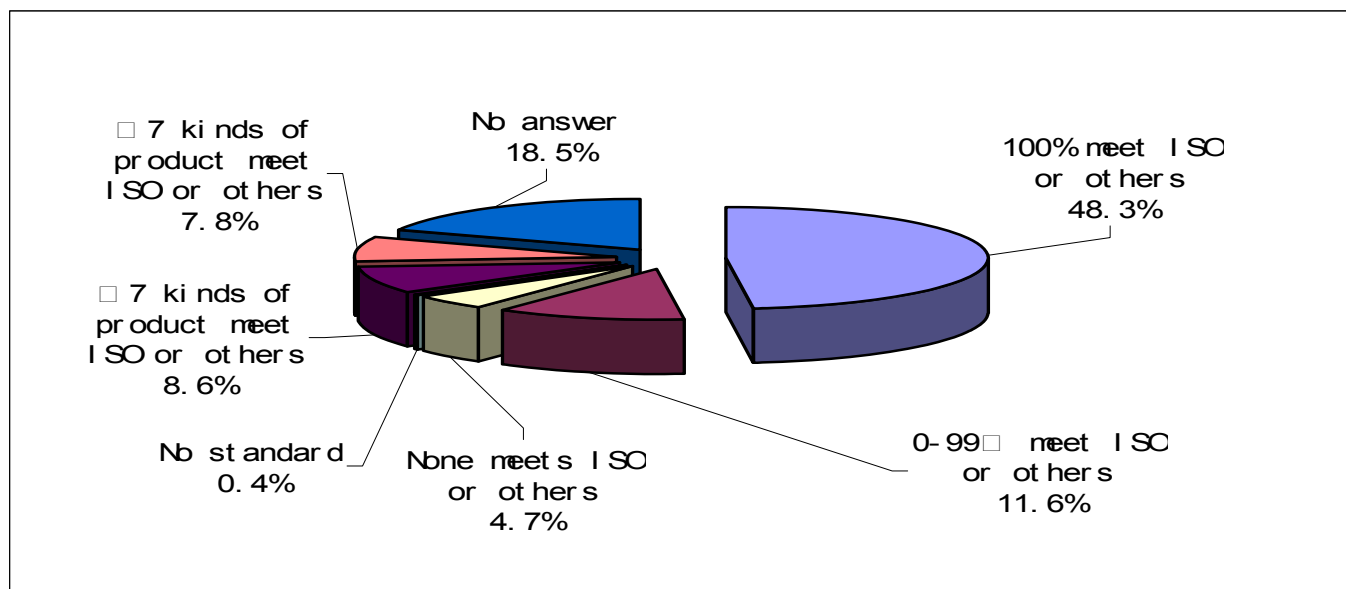


Source: Author's computations based on the survey data.

Figure 5 shows that, among the sample firms, 48.3% responded that they had International Organization for Standardization (ISO) certification or another form of internationally-agreed certification for 100% of their products, while another 11.6% responded that 1–99% of their products had attracted certification. Only 4.7% of firms responded that none of their products had obtained any form of certification.

<sup>7</sup> Export processing zones are designated areas in a country where particular trade barriers such as tariffs and quotas are eliminated and bureaucratic requirements are lowered, in the hope of attracting new business and foreign investments. The first EPZ was inaugurated in Kunshan, PRC in April 2000. As of January 2010, there were 58 EPZs in the PRC.

**Figure 5: Number of Products or Systems attracting ISO Certification or Other Form of Internationally-Agreed Certification (% of sample firm responses)**

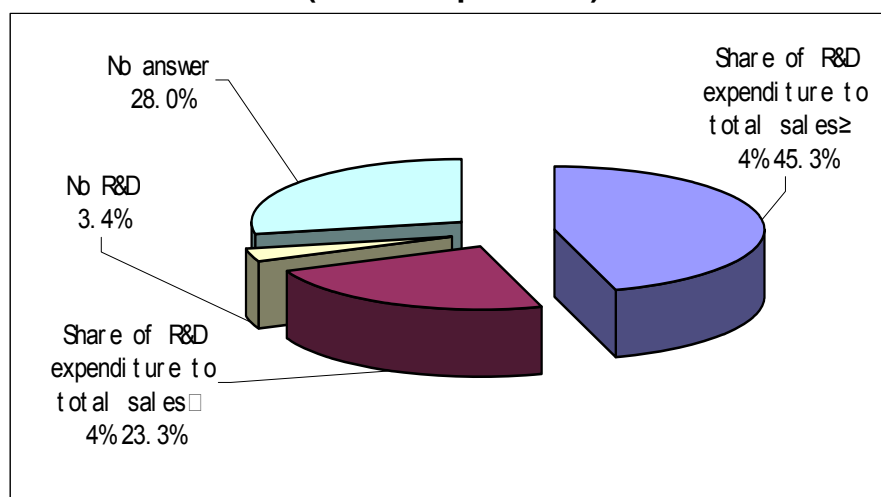


Source: Author's computations based on the survey data.



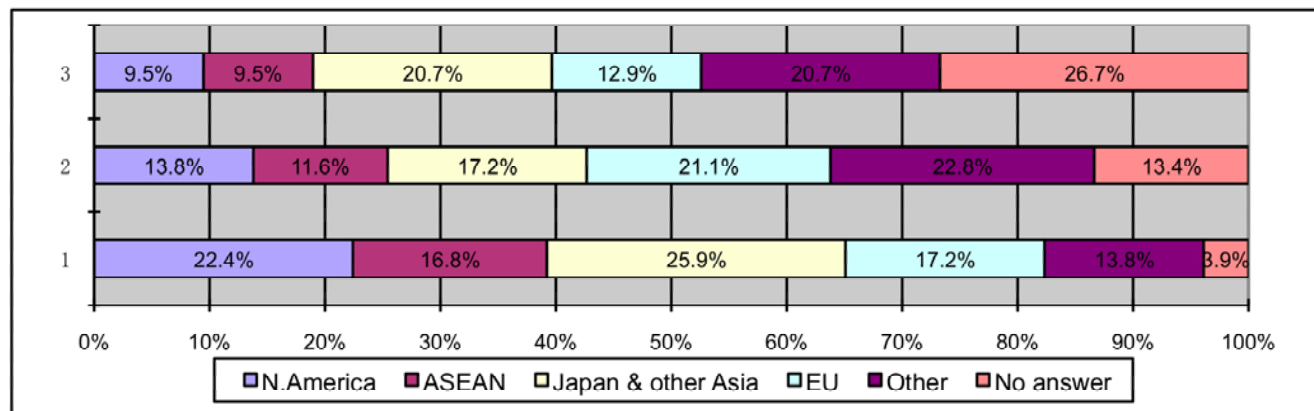
By its nature, the level of research and development (R&D) expenditure undertaken by any firm tends to be representative of both the quality of the firm's products and the firm's competitiveness. Presently, the R&D expenditure of many firms is limited. Nevertheless, the firms interviewed for this survey indicated their strong interest in spending on R&D. As shown in Figure 6, 23.3% of firms spent more than 4% of their sales income on R&D, while only 3.4% made no expenditure on R&D at all. The share of firms that gave no answer to this question was unfortunately high (28.0% of firms).

**Figure 6: Share of R&D Expenditure to Total Sales Income  
(% of sample firms)**



Source: Author's computations based on the survey data.

Figure 7 shows the direction of firms' exports. Asian markets are the number one export destination for 42.7% of the sample firms, with ASEAN coming in as the top export market for 16.8% of sample firms. Following Asia are North America and the EU, with 22.4% and 17.2% of firms respectively listing them as their number one export market. Asia also continued to rank highly as the second most important export destination for sample firms, with ASEAN being selected by 11.6% of the sample. In this category, the EU was regarded more highly than North America, with 21.1% and 13.8% of firms respectively considering these markets their second most important for exports. It is interesting that ASEAN is considered to be one of the top three export markets for a significant number of firms—this perhaps reflects the effect of the ASEAN-PRC CECA, as it was implemented earlier than the others, starting with the liberalization of trade in goods.

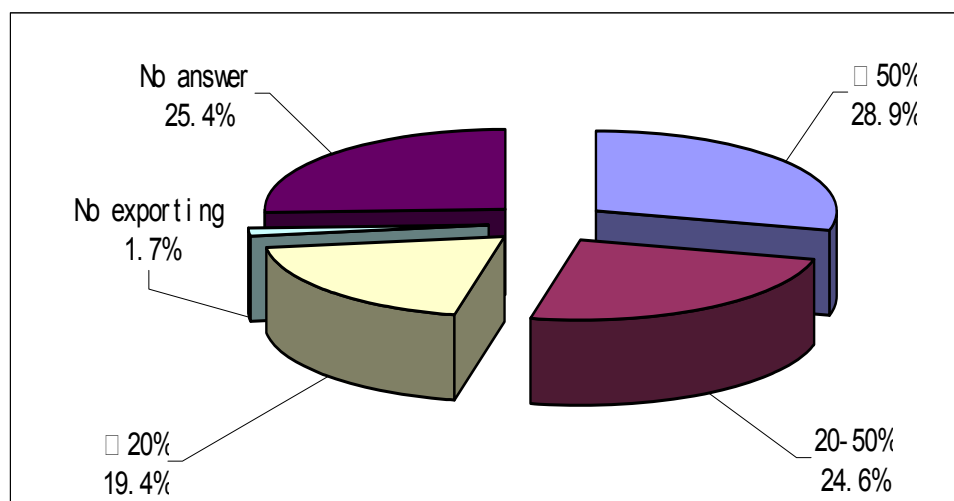
**Figure 7: Firms' Top Three Market Destinations for Exports (% of sample firms)**

Note: North America refers to the US, Canada, and Mexico.

Source: Author's computations based on the survey data.

Figure 8 indicates the percentage share of exports in firms' total sales. Almost 30.0% of the firms surveyed produced more than half of their products for export, while 24.6% produced between 20 and 50% of their products for export. The actual dependency upon export business may be higher in reality, yet hidden by the high proportion of respondents (27.2%) who gave no answer.

**Figure 8: Firms' Share of Exports in Total Sales (2007) (% of sample firms)**



Source: Author's computations based on the survey data.

## 2.3 FTA Use

Governments negotiate and sign FTAs in order to provide a better environment for business and the greater the rate at which firms utilize FTAs, the greater the benefits that can be realized. This section analyzes the use of FTAs by PRC firms in two ways. First, it examines utilization rates in a direct sense, by calculating the share of firms that use or intend to use FTAs. Second, it examines the degree of FTA coverage of firms' exports, by calculating the share of their total exports that are able to benefit from FTA provisions.

Of the responding firms, 45% (102 firms) stated that they used at least one FTA and 78% (176 firms) said that they used or planned to use FTAs in the future. Such high prospective use figures suggest that Chinese exporters are aggressively considering FTAs as a trade policy strategy. Table 8 summarizes the utilization rates (actual and prospective) of specific FTAs in effect, under negotiation, and proposed.

**Table 8: Utilization Rates by FTA**

<b>Agreement</b>	<b>Use</b>		<b>Plan to Use</b>	
	<b>Number of firms</b>	<b>Share of FTA users, % (n = 102)</b>	<b>Number of firms</b>	<b>Share of respondents, % (n = 226)</b>
<b>Signed or In Effect</b>				
ASEAN-PRC CECA	67	65.7	50	22.1
PRC-Hong Kong, China CEPA	47	46.1	32	14.2
PRC-Chile FTA	33	32.4	28	12.4
PRC-Pakistan FTA	22	21.6	31	13.7
PRC-New Zealand FTA	15	14.7	37	16.4
PRC-Macau, China CEPA	15	14.7	25	11.1
<b>Under Negotiation</b>				
PRC-Australia FTA			41	18.1
PRC-Singapore FTA			25	11.1
PRC-GCC FTA			17	7.5
PRC-Costa Rica FTA			11	4.9
PRC-Iceland FTA			12	5.3
<b>Proposed</b>				
PRC-Japan-Korea FTA			39	17.3
PRC-SACU FTA			35	15.5
PRC-India FTA			33	14.6
CEPEA (ASEAN+6)			31	13.7
EAFTA (ASEAN+3)			29	12.8
PRC-Korea FTA			24	10.6
PRC-Peru FTA			20	8.8
PRC-Norway FTA			17	7.5

ASEAN = Association of Southeast Asian Nations; CECA = comprehensive economic cooperation agreement; CEPA = comprehensive economic partnership agreement; CEPEA = Comprehensive Economic Partnership for East Asia; EAFTA = East Asian Free Trade Agreement; EFTA = European Free Trade Association; EPA = economic partnership agreement; FTA = free trade agreement; FTAAP = Free Trade Area of the Asia-Pacific; GCC = Gulf Cooperation Council; Korea = Republic of Korea; PRC = People's Republic of China; PTA = preferential trade agreement; SACU = Southern African Customs Union

Note: Plan to use does not include firms currently using that FTA. Firms may use or plan to use more than one FTA.

Source: Author's computations based on the survey data.

Among the firms that made use of FTAs, the ASEAN-PRC CECA was by far the most popular agreement (65.7%). The PRC-Hong Kong, China CEPA had the second highest usage rate at 46.1% (47 firms), followed by the PRC-Chile FTA (32.4%). Among prospective users, 22.1% of responding firms anticipated using the ASEAN-PRC CECA in the future; 16.4% planned to use the PRC-New Zealand FTA; 14.2% planned to use the PRC-Hong Kong, China CEPA; and 13.7% planned to use the PRC-Pakistan FTA. The importance of the ASEAN-PRC FTA reflects the growing importance of regional markets to PRC exporters (Hong 2008). In fact, Hong Kong, China's importance as a trade center for the PRC may soon be overshadowed by ASEAN, although for small and medium firms Hong Kong, China

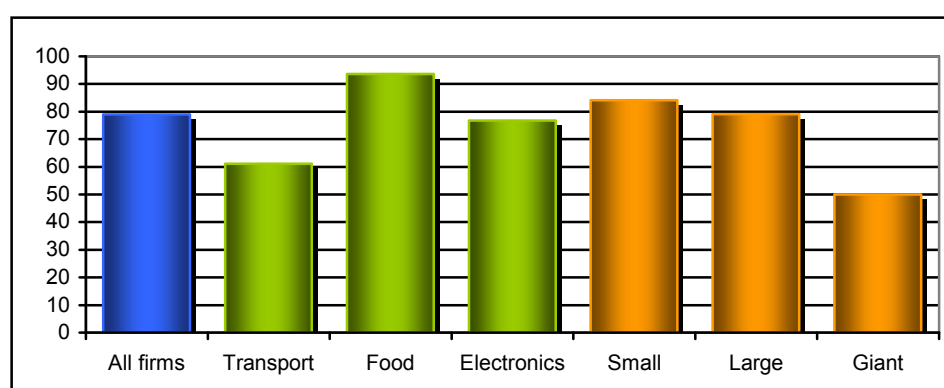
is still a significant market for exports. The lower numbers of firms that used or planned to use either the PRC-Chile or PRC-Pakistan FTAs may reflect the fact Chile and Pakistan do not constitute significant markets for firms' exports at this time.

Table 8 also shows that among the four FTAs under negotiation, 18.1% of responding firms (41 firms) planned to use the PRC-Australia FTA and 11.1% (25 firms) planned to use the PRC-Singapore FTA.<sup>8</sup> The higher proportion of firms planning to use these two particular FTAs may reflect the expectation on the part of Chinese firms that they will increase their exports to these markets in the future. In contrast, the expected usage rates for the PRC-GCC FTA, PRC-Costa Rica FTA, and PRC-Iceland FTA are significantly lower.

There are also many proposed FTAs that are under academic or official feasibility study by the PRC and its partners. Of the proposed FTAs, 17.3% of responding firms (39 firms) planned to use the PRC-Japan-Korea FTA, 15.5% (35 firms) planned to use the PRC-SACU FTA, 14.6% (33 firms) planned to use the PRC-India FTA, and approximately 13.0% (around 30 firms) planned to use the two East Asian FTAs. The prospective support for these proposed FTAs heralds a growing interest among Chinese firms in the potential of the East Asian, Indian, and South African markets for their products, which may increase further as the studies progress.

While utilization rates, as defined by incidence of use, are relatively high among PRC firms, the share of exports covered by FTAs is lower (Figure 9). Of responding firms, 8.8% (12 firms) have FTA coverage for 50% or more of their exports, 11.0% (15 firms) have coverage between 20% and 50%, 33.1% (45 firms) have coverage for less than 20% of exports, and almost half (64 firms) have no FTA coverage for exports. This variable coverage of export value by FTAs reflects the present market orientation of PRC firms toward traditional markets such as the United States. As rebalancing of growth takes place, there may be a shift in market orientation toward ASEAN and regional markets and the use of FTAs may intensify accordingly.

**Figure 9: FTA Coverage of Exports (% of respondents)**



Note: The number of responding firms was 136.

Source: Author's computations based on the survey data.

## 2.4 Impediments to Use

If FTAs can help firms export, why are utilization rates not higher? Firms face many barriers to using FTAs (Table 9). The survey found that the most significant impediment to FTA use, as indicated by 45.1% of all firms and 62.9% of non-user firms, was lack of information. While lack of information appears to be a general problem among firms, it is particularly problematic among firms that do not use FTAs, demonstrating that this information gap

<sup>8</sup> The PRC-Singapore FTA was signed in October 2008.

among Chinese exporters has a significant negative effect on usage rates. The other top reasons given for non-usage were time delays in and administrative costs of applying for certificates of origin (COs), small margins between the most-favored nation (MFN) and preferential rates, and the use of alternative incentive schemes that give duty-free treatment. However, the difference in the number of non-user firms versus total firms that consider delays and administrative costs an impediment to FTA use (14.5% of non-users versus 10.6% of total users) is notable in that it indicates that the process of preparing applications for COs may not be as cumbersome as expected.

**Table 9: Impediments to FTA Use (number of responding firms [% of respondents])**

Impediments	Non-users only	Total
Lack of information	78 (62.9)	102 (45.1)
Delays and administrative costs for COs	18 (14.5)	24 (10.6)
Small margin of preference	17 (13.7)	32 (14.2)
Use of EPZ schemes and/or ITA	15 (12.1)	20 (8.8)
Confidentiality of information required in CO forms	13 (10.5)	24 (10.6)
Arbitrary classification of origin	8 (6.5)	12 (5.3)
Too many exclusions	8 (6.5)	10 (4.4)
Non-tariff measures used by FTA partners	6 (4.8)	14 (6.2)
<b>Number of responding firms</b>	<b>124</b>	<b>226</b>

CO = Certificate of Origin; EPZ = export processing zone; FTA = free trade agreement; ITA = World Trade Organization Information Technology Agreement

Note: Multiple answers allowed

Source: Author's computations based on the survey data

## 2.5 Costs and Benefits of Selected FTAs

**Positive impacts.** Overall, firms experience net benefits from FTAs. More than half of the responding firms identified an increase in export sales as one of the most significant benefits of the ASEAN-PRC CECA (Table 10). This demonstrates that Chinese firms are interested in market access, i.e., in increasing exports to partner markets. The PRC's exports are embedded in the regional production network, and highly reliant on FDI flows and the external supply of raw materials and intermediate goods. Accordingly, 89 firms (39.2% of responding firms) also reported greater convenience, 76 firms (33.5%) reported promotion of FDI and new business opportunities, and 63 firms (27.8%) cited lower tariffs as important positive effects of the ASEAN-PRC CECA on their businesses. The deepening of the production network and supply chain was cited as a positive effect by 39 firms (17.2%). While Chinese exporters are increasingly connected to regional and global production networks, the majority of Chinese firms are still native producers, manufacturing at the lower end of the chain in production networks dominated by very large multinational corporations (MNCs).

**Table 10: Benefits and Costs of Selected FTAs (number of firms [share of responding firms %])**

	<b>ASEAN- PRC CECA</b>	<b>PRC-Chile FTA</b>	<b>PRC- Pakistan FTA</b>	<b>PRC-New Zealand FTA</b>
<b>Benefits</b>				
Cheaper intermediate goods due to lower tariffs	63 (27.8)	25 (11.0)	17 (7.5)	20 (8.8)
Increase in export sales	124 (54.6)	43 (18.9)	33 (14.5)	50 (22.0)
Promotion of FDI and new business opportunities	76 (33.5)	24 (10.6)	24 (10.6)	29 (12.8)
Greater convenience due to easier facilitation	89 (39.2)	36 (15.9)	36 (15.9)	37 (16.3)
Deepening of production network and supply chain	39 (17.2)	9 (4.0)	9 (4.0)	14 (6.2)
<b>Costs</b>				
Increased competition	69 (30.4)	18 (7.9)	16 (7.0)	20 (8.8)
Documentation costs and time delays	54 (23.8)	27 (11.9)	16 (7.0)	19 (8.4)
Disadvantage with precedent FTAs	18 (7.9)	3 (1.3)	6 (2.6)	6 (2.6)
Relocation of production	14 (6.2)	5 (2.2)	4 (1.8)	4 (1.8)

CECA = closer economic cooperation agreement; FTA = free trade agreement

Note: Multiple responses allowed. The number of responding firms was 227.

Source: Author's computations based on the survey data.

For new markets like Chile and New Zealand, the most significant benefits were an increase in export sales due to widening market access, cited by 43 firms for the PRC-Chile FTA (18.9%) and 50 firms for the PRC-New Zealand FTA (22.0), and greater convenience in exporting, cited by 36 firms (15.9%) and 37 firms (16.3%) for each FTA respectively. This reflects the fact that Chinese firms, along with promoting a regional focus, still practice a “go outside” policy as a way to take advantage of outside markets, particularly for raw materials and primary products. For the PRC-Pakistan FTA, 36 firms (15.9%) cited greater convenience due to easier facilitation as the most significant benefit, and 33 firms (14.5%) cited increase in exports sales due to widening market access. Chinese firms may view Pakistan as an attractive investment location for the purpose of lowering production costs.

**Negative impacts.** The most negative impacts of the ASEAN-PRC CECA were increased competition from imported products cited by 69 firms (30.4%) and documentation and time delays related to FTA use cited by 54 firms (23.8%). Firms' concerns about increased competition from ASEAN imports reflect the likelihood that many ASEAN manufacturers would produce similar products to PRC firms within the multinational corporation-created regional production network. PRC exporters are also concerned about the complex and time-consuming procedures necessary to obtain proper documentation for their export products. PRC firms are less concerned about being negatively impacted by relocation of production and competitive disadvantage with precedent FTAs, given the strong labor market and abundance of available capital that continues to ensure their competitiveness.

With the PRC-Chile FTA, documentation costs and time delays and increased competition from imported products were again the top two perceived negative impacts, with the former cited by 27 firms (11.9%) and the latter cited by 18 firms (7.9%). This higher perception of the negative impacts of documentation may reflect the fact that Chile is a geographically distant market and firms may be concerned about time delays affecting export schedules. With the PRC-New Zealand FTA, 20 firms (8.8%) rated increased competition from imported products as a negative impact and 19 firms (8.4%) were concerned about the negative impact of documentation costs. With regard to the PRC-Pakistan FTA, only 16 firms (7.0%) ranked increased competition from imported products and documentation costs as negative

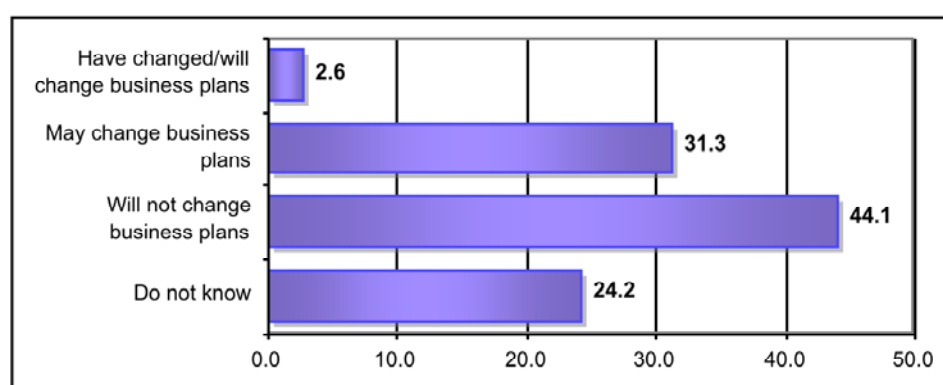
impacts, which may allay some concern about competition generated by low-priced products manufactured in Pakistan.

## 2.6 Business Responses to FTAs

Generally speaking, it is to be expected that once firms have gauged the impacts of FTAs they will adjust their business plans to maximize the benefits of these agreements to their business and minimize the costs. The survey results demonstrate, however, that PRC firms have not responded so actively. Only 2.6% of respondents (6 firms) stated that they had changed or planned to change their business plans in response to FTAs (Figure 10). The small share of definite affirmative responses may imply that FTAs have had limited impact on firms' decisions. Still, 31.3% of respondents (71 firms) stated that they may change their business plans, reflecting the potential for firms to become more responsive to FTAs in the future.

Of the 102 firms that used FTAs, only 3 answered that they have changed or will change their business plans, whereas 39 firms responded that they may change their business plans. In contrast, 46 FTA users indicated that they have not and would not change their business plans, while 14 firms responded "don't know." One of the reasons why the firms surveyed may be reluctant to change their business plans is that they are still in a transitional period of becoming accustomed to FTAs, the details of which remain out of their control.

**Figure 10: Firms' Business Strategy Responses to FTAs (% of respondents)**



Note: The number of responding firms was 227.

Source: Author's computations based on the survey data.

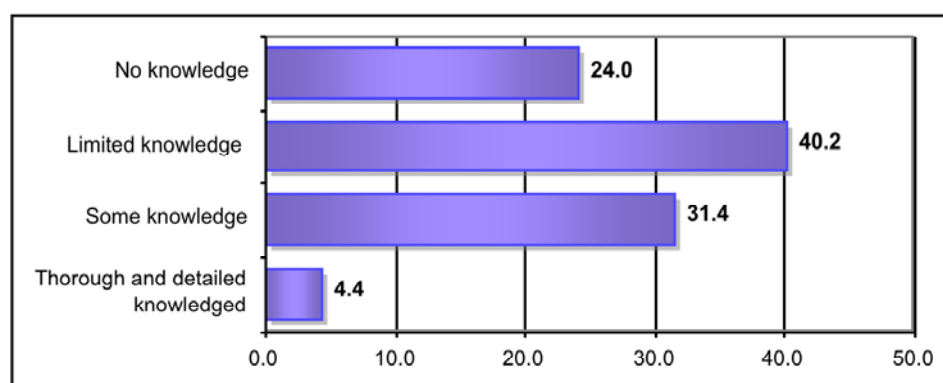
In order to understand the reasons behind this general lack of business response to FTAs, the survey investigated the extent to which the firms possessed detailed knowledge of the relevant FTAs. Only 10 firms (4.4% of the 229 responding firms) claimed to have a thorough and detailed understanding of FTA provisions (Figure 11). Most of the firms responded that they had not studied the texts at all (24.0% of respondents), that they had limited knowledge of FTAs (40.2% of respondents), or that they had knowledge of some aspects of FTA provisions (31.4%). This low level of knowledge of FTA provisions could be the result of three possible conditions: a general lack of interest in FTAs, inadequate FTA training and outreach, or the particular corporate officers who responded to the survey lacked knowledge of FTAs. The limited knowledge of FTA provisions professed by those surveyed indicates that there is great need for the government to provide additional professional training for the business community.

SMEs, in particular, may have difficulty making full use of FTAs due to their limited human resources and level of management training, and so would likely welcome professional training sponsored by the government or commercial enterprises. Over 60% of responding SMEs professed to have either no knowledge or limited knowledge of FTAs. Some



knowledge of FTA provisions was professed by 33.7% of responding SMEs and a scant 3.1% claimed to have detailed knowledge of FTAs.

**Figure 11: Firms' Knowledge of FTA Provisions (% of respondents)**



Note: The number of responding firms was 229.

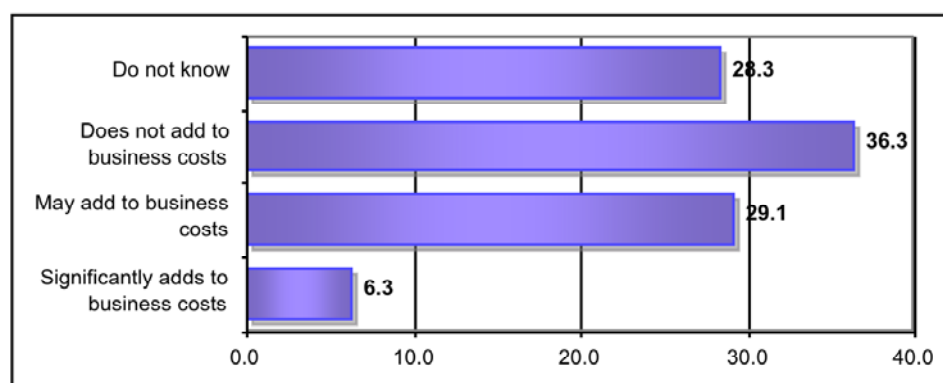
Source: Author's computations based on the survey data.

## 2.7 Rules of Origin

Rules of origin (ROOs) play an important role in FTA use because all products that could potentially benefit from liberalization measures must be able to comply with these rules. ROOs may create three kinds of problems for businesses: arranging certification of products may be time consuming and costly, differences between ROOs may make transactions more complex, and different FTAs may result in overlapping ROOs, the so-called “noodle bowl” effect (see Kawai and Wignaraja 2009 for a detailed discussion of the Asian “noodle bowl” phenomenon).

### 2.7.1 The Asian “Noodle Bowl” of Overlapping ROOs

Despite theoretical concerns over the “noodle bowl” effect, only 6.3% (14 firms) of responding firms stated that multiple ROOs significantly added to business costs (Figure 12). This may reflect the extent to which production processes requiring frequent border crossings are outsourced and, with them, the work of complying with certificate of origin requirements and qualifying for tariff concessions. Such outsourcing may reduce the perceived negative impacts of dealing with multiple ROOs. While it may not be difficult for products to meet the requirements of the ROO system, the associated documentation may still be very complex (Cheong and Cho 2006). Also, the ambiguity evident in the high number of “maybe” and “do not know” responses to questions regarding the effects of ROOs on business costs may also indicate that many PRC firms have not yet understood how overlapping ROOs could be a significant problem for their businesses.

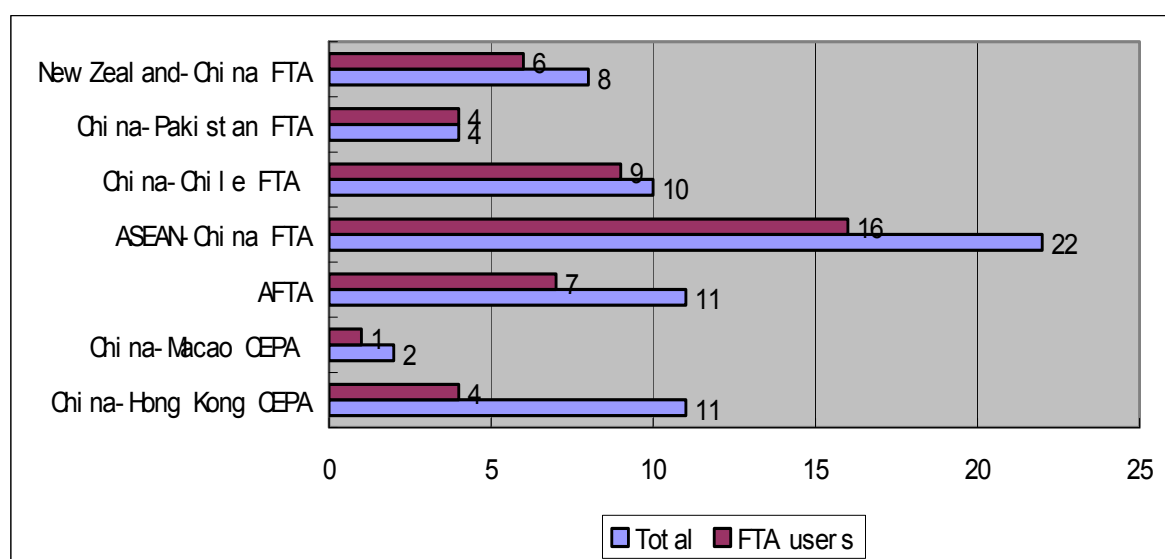
**Figure 12: Firms Perceptions of Impacts of ROOs (% of respondents)**

Note: The number of responding firms was 223.

Source: Author's computations based on the survey data.

While multiple ROOs are not perceived to be costly by the surveyed firms overall, the reported cost increases among firms that use FTAs. Twelve firms out of the 102 FTA users (11.8%) stated that multiple ROOs significantly added to their business costs. When we combine the 11.8% of FTA users that perceive a significant addition to business costs from FTAs with the 33.3% who responded that FTAs may impose significant burdens, we see nearly half of FTA users perceiving actual or potentially significant costs from the negative effects of multiple ROOs, reflecting that there may be greater costs in practice than expected.

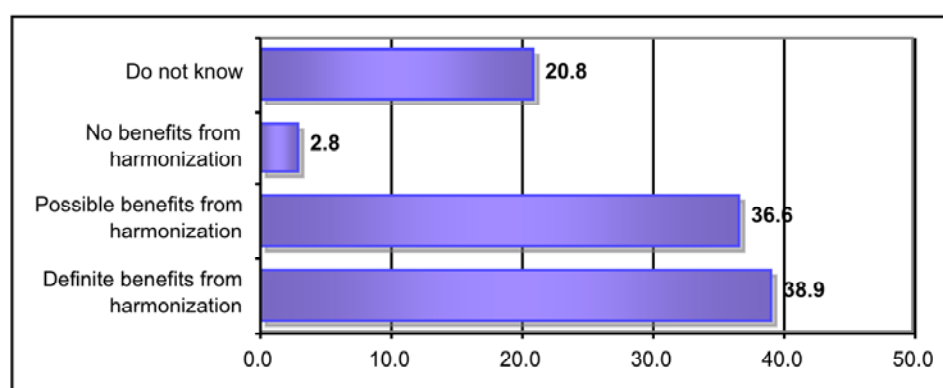
Figure 13 offers a breakdown regarding perceptions of the existence of problems with ROOs in relation to specific FTAs. Of the total field of respondents, 22 firms indicated that ROO compliance was problematic with the ASEAN-PRC CECA; 8 firms indicated the PRC-New Zealand FTA; 11 firms perceived problems with the PRC-Hong Kong, China CEPA and the ASEAN Free Trade Area (AFTA); and 10 with the PRC-Chile FTA. Four firms indicated ROO problems with the PRC-Pakistan FTA and two with the PRC-Macao CEPA. Perhaps a larger number of firms identified ROO problems with the ASEAN-PRC CECA because more firms actually use it, as may be the case with the PRC-Hong Kong, China CEPA. The marginal perception of problems with the PRC-Pakistan FTA and the PRC-Macao CEPA may be the result of their lower utilization rates. The proportional results across FTAs were very similar for FTA users, although the absolute numbers of FTA users indicating problems with each FTA (given that FTA users constitute only 44% of the survey sample) makes it clear that the majority of ROO problems are perceived by those who actually deal with ROOs in practice.

**Figure 13: ROO Problems for Selected FTAs (number of firms)**

Note: Firms were able to provide multiple answers. AFTA = ASEAN Free Trade Area. CECA= closer economic cooperation agreement; CEPA = comprehensive economic partnership agreement; FTA = free trade agreement

Source: Author's computations based on survey data.

One way to prevent problems arising from overlapping ROOs would be to harmonize the ROOs between FTAs. Asked whether they would benefit from harmonized ROOs, 84 firms (38.9% of the 216 responding firms) replied that they would and 79 firms (36.6%) replied that they probably would. With over 70% of firms responding positively to the suggestion of harmonization of ROOs, it seems that a single, region-wide, plurilateral ROO regime could be an effective mechanism through which to avoid the costs created by the “noodle bowl.”<sup>9</sup>

**Figure 15: Benefits from Harmonization of ROOs? (% of respondents)**

Note: The number of responding firms was 216.

Source: Author's computations based on the survey data.

Asked about their preferences for ROO harmonization, 31 firms replied that they would prefer a value-added (VA) based measurement, while 24 firms preferred a change in tariff classification (CTC) rule. A further 41 firms replied that they would prefer the option to choose between a value content (VC) rule and a CTC rule.

The preferences of the firms surveyed were distributed relatively equally across the three possible rules of VA, CTC, or the option to choose between VC and CTC. This broad

<sup>9</sup> Feasibility studies on the EAFTA (ASEAN+3) and the CEPEA (ASEAN+6) have recommended the creation of a regional ROO regime. For the regional production network, a single ROO regime for ASEAN+3 would seem more urgent (Kawai and Wignaraja 2008).

distribution suggests that PRC firms are still in the process of developing into transnational companies. This is illustrated when PRC firms are contrasted with Japanese transnational firms, few of which expressed a preference for a VC rule. The absence of a clear preference among firms could make the project of harmonizing ROOs more difficult. In recognition of the fact that many PRC firms do not thoroughly understand ROOs, it would be beneficial for the government to sponsor the creation of an institution that could educate firms about ROOs in general, the differences between VA, VC, and CTC, and their respective advantages and disadvantages.

However, 129 firms out of the total survey sample indicated that they would prefer to be able to self-certify their own certificates of origin. This high preference for self-certification indicates that the existing certificate-issuing authority, with its demanding requirements for documentation, does not fit with the trade environment and is particularly in conflict with just-in-time production systems. A self-certification system in which exporters are responsible for preparing their own documents would greatly simplify the certification process, enabling firms to save time and money. The government should examine this option in light of the high number of firms that perceive documentation costs as a negative aspect of FTAs.

When current FTA users responded to the question of self-certification, 59 firms gave affirmative responses and the number of potentially positive attitudes climbs to 80 firms when the “maybe” responses are included. Only 16 firms replied that they were against this scheme and only 5 FTA-using firms responded “don’t know.” It is difficult to understand why the majority of respondents, whether current FTA users or not, were so unequivocally in favor of self-certification when only 4.3% of firms professed a deep understanding of FTAs. It may simply be that, regardless of any FTA’s rule system specifics, self-certification is seen as a time and cost saving measure that could provide welcome relief from cumbersome red tape and long delays—which were viewed by firms as a negative impact of FTAs (see Section 2.5).

## **2.8 FTA Policy Issues and Institutional Support**

Institutional support for firms using FTAs is important. Two main sources of institutional support are available to firms when they encounter an FTA-related problem: government agencies and non-governmental sources such as business associations.

The main government agencies involved in assisting firms with issues regarding FTA usage and certificate of origin applications in the PRC are: the Ministry of Commerce (including local departments of commerce), China Customs, the Ministry of Foreign Affairs, and other agencies such as the State General Administration for Quality Supervision, Inspection, and Quarantine. The Ministry of Commerce is directly responsible for negotiating, implementing, and monitoring the various regional and bilateral FTAs. Its web site contains important FTA information including legal texts and instructions for obtaining further assistance. Further, the Ministry of Commerce and the local departments of commerce are responsible for introducing FTAs by distributing information and organizing FTA seminars and training programs. China Customs is the agency authorized to issue certificates of origin under existing FTAs and to implement policies on tariff reductions and other non-tariff barrier reduction measures. The Ministry of Foreign Affairs does not deal directly with FTA issues; its primary role with regard to FTAs is to provide basic information on negotiations. Other governmental agencies provide concrete information to help firms comply with FTA provisions and make full use of concluded FTAs.

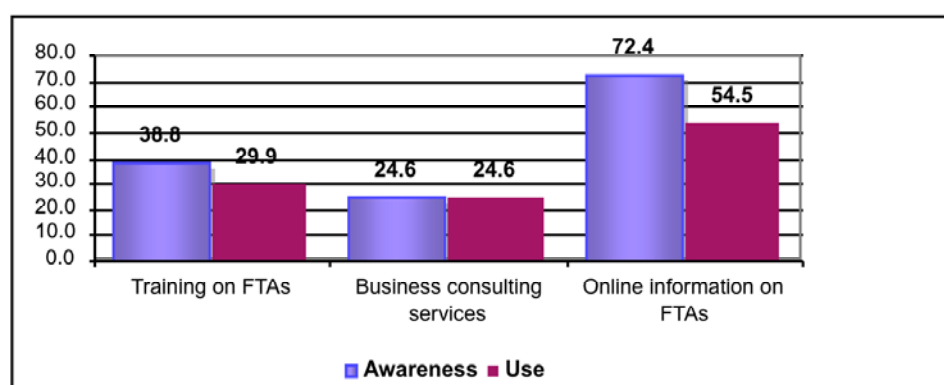
Overall, PRC firms seek support more from governmental and public sources than from private sector sources such as business associations. When seeking FTA-related assistance from government agencies, 135 firms would go to the Ministry of Commerce while 114 firms indicated China Customs as a source of support. Other government agencies, including the Ministry of Foreign Affairs, seem to play only a marginal role (used by only 22 firms). These figures indicate that the Ministry of Commerce and China Customs have important roles to

play in helping firms to use FTAs for exports and therefore should strengthen their capacities to support the business community's use of FTAs for exports and the expansion of services and FDI flows.

Non-government agencies are another source of assistance for firms and include the Chamber of Commerce, other smaller business associations, law firms, and private consultants. Almost half of the respondents (103 firms) had sought assistance from the Chamber of Commerce and 22 firms also indicated business associations as a source of help in dealing with FTA issues, followed by law firms and private consultants (indicated by a total of 60 firms).

When firms were asked about their knowledge of the specific FTA services provided by different government agencies, their awareness of most services showed room for improvement (Figure 16). Only 52 firms (38.8% of responding firms) were aware of the FTA training services provided by government agencies and just 33 firms (24.6%) were aware that government agencies offered FTA-related business consulting services. A higher number of respondents (97 firms or 72.4%) stated that they were aware of government-sponsored web sites on FTAs. This high awareness rate of the provision of online information regarding FTAs is probably attributable to the convenience that web sites offer as sources of information.

**Figure 16: Awareness and Use of Government FTA Services (% of respondents)**

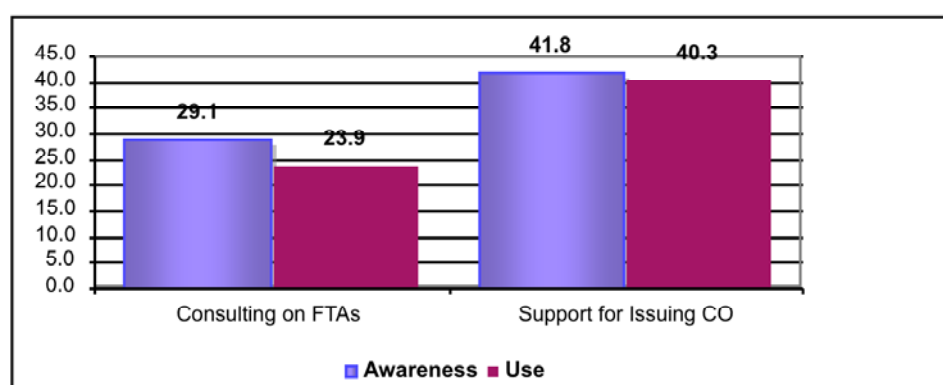


Note: Multiple answers allowed. The number of responding firms was 134.

Source: Author's computations based on the survey data.

While online FTA information and resources were the most known among the firms, the proportion of firms that reported using these services was much lower (54.5% of respondents). This suggests that firms may desire more interactive information sources from the government or that the information on web sites is not meeting all of firms' information needs. The responses regarding business consulting services suggest that firms made aware of these services are apt to use them: while awareness of business consulting services was the lowest among the services (24.6% of respondents), an equal percentage of respondents reported using these services.

Awareness of non-government services ranged from 29.1% (39 firms) for consulting services to 41.8% (56 firms) for support on the issuance of certificates of origin (Figure 17). Usage rates were generally similar to awareness rates, suggesting that when firms are made aware of services from non-governmental sources, they are likely to use them.

**Figure 17: Awareness and Use of Non-Governmental FTA Services (% of respondents)**


Note: Multiple answers allowed. The number of responding firms was 134.

Source: Author's computations based on the survey data.

Table 11 shows firms' impressions of the quality of various types of support offered by the government and the private sector—including government trainings on FTAs, government and private consulting services for firms, online information and resources, and support for certificate of origin issuance. Firms that reported actually using FTAs consistently gave higher ratings for FTA support services than the total survey sample, which includes non-users. The data indicates that there is scope for improvement in the general quality of services provided by government and the private sector.

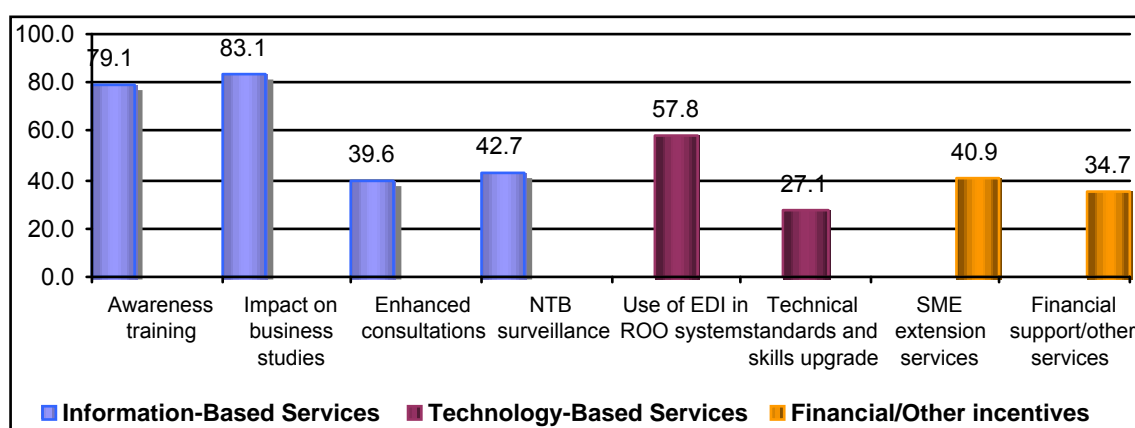
**Table 11: Quality Assessment of Government and Non-Governmental Services**

FTA Support Services	Quality Level (1-5)	
	All respondents	FTA-users only
<b>Government Services:</b>		
Training	2.4	2.7
Online information	2.8	3.0
Business consulting services	2.5	2.5
<b>Non-Governmental Services:</b>		
Support for issuing certificates of origin	3.3	3.5
Business consulting services	2.8	2.9

Note: Rated by firms on a scale of 1 to 5 where 5 is the highest quality.

Source: Author's computations based on the survey data.

Considering that lack of information was the most significant barrier to FTA use among Chinese firms, it no surprise that the majority of firms demanded additional services related to the provision of information. These included awareness training on FTA provisions (79.1%), studies on the impacts of FTAs on businesses (83.1%), monitoring and surveillance of non-tariff barriers (42.7%), and enhanced consultations during FTA negotiations (39.6%) (see Figure 18 for a summary of services desired). Therefore, the government and the private sector should devote more resources to providing these services. There was also demand for technology-based services: 57.8% of firms expressed a desire for upgrades to electronic data interchange systems, while 27.1% demanded upgrades of technical standards and training to upgrade skills. Services for SMEs were also in demand: about 40.9% of firms sought SME extension services and 34.7% sought financial support or other services.

**Figure 18: FTA Support Services Desired by Firms (% of respondents)**

Note: Multiple answers allowed. The number of responding firms was 225.

EDI = electronic data interchange; FTA = free trade agreement; NTB = non-tariff barrier; ROO = rule of origin; SME = small or medium enterprise.

Source: Author's computations based on the survey data.

## 3. CONCLUSION

### 3.1 Concluding Points

Free trade agreements (FTAs) have become an important part of the People's Republic of China (PRC's) trade and economic policies and the PRC plans to take part in more FTAs in the future. This study has analyzed data from interviews undertaken with 232 firms that were randomly selected to cover a range of businesses, representative in terms of size, ownership, age, industry, and location. The selected firms were all characterized by high or relatively high dependence on export markets for their products.

The following is a summary of the key findings:

- ***Incidence of FTA use is high and is set to rise.*** The interviews revealed that among the firms surveyed, 45% were already using FTAs to some extent, while 78% were using or planned to use FTAs. While this utilization rate is relatively high, the coverage of export value by FTAs is not extensive. Use of FTAs, as well as intensity of use (determined by export coverage), can be improved by mitigating the barriers to FTA use. The main impediments to use reported by the firms surveyed, in order of impact from highest to lowest, were lack of information on FTAs, small margin of preferences, confidentiality of information required in certificate of origin forms, and time delays in and administrative costs of preparing applications for certificates of origin.
- ***Firms' perceptions of FTAs' impact on business were net positive.*** The benefit reported by the largest number of firms was an increase in export sales due to widening market access followed by greater convenience due to easier facilitation. The negative impacts most cited were increased competition from imports and documentation and time delays related to FTA use. The negative perceptions regarding FTA-related documentation indicate that firms remain concerned about red tape issues even after market liberalization.
- ***Firms are considering adjusting business strategies in response to FTAs but remain uninformed of the details of provisions.*** Of the firms surveyed, 77 indicated that they had or might change their business plans in response to FTAs. While firms are considering taking an active stance in responding to FTAs, they still

have limited knowledge of the details of FTA provisions. Only 10 firms claimed to have thorough and detailed knowledge of FTAs. A further 72 firms professed to have some knowledge of FTA provisions. These figures reflect a significant lack of information available to firms.

- **Only about 6% of firms definitely consider multiple ROOs to be costly to business.** Rules of origin (ROOs) have a significant impact on FTA use because all products that could benefit from liberalization are required to comply with ROOs. In general, a relatively low number of exporting firms considered multiple ROOs to be problematic, though in practice multiple ROOs may be costlier than expected with nearly 12% of FTA users indicating that they imposed costs and one third of firms responding that ROOs might potentially add to costs. This perceived potential cost may be attributed to the fact that firms are still unfamiliar with ROOs in practice, especially considering that export coverage by FTAs is relatively low. With regard to proposals for ROO harmonization, there was a fairly even spread of firm preferences among the options (value-added [VA], change of tariff classification [CTC], or a choice between value content [VC] and CTC). However, a high proportion of respondents indicated their preference for a ROO scheme that allowed for self-certification, which could significantly simplify ROO procedures. Firms also expressed the hope that government agencies would improve their information services and ROO certification processes.
- **Firms want more FTA-related services.** Many firms remained unaware of the services provided by government agencies and/or non-government agencies such as business associations. This indicates that outreach programs could be more effective in informing the business sector of the range of services available. The findings suggest that when firms are aware of these services, they are likely to use them. Among the services desired by PRC firms, FTA-related information services were the most cited. These should be considered of great importance to those agencies wishing to promote the use of FTAs.

### 3.2 Policy Recommendations

- The PRC is a major player in the global trading system. The FTAs concluded between the PRC and its trading partners thus have a significant impact on both the PRC and the global trading system. As a result, concluded FTAs should be consistent with this system, i.e., with World Trade Organization rules. The gradual approach taken by the PRC toward FTAs thus far has been appropriate to its capacities as a developing country. However, as domestic firms continue to grow in regional and global capacity and move toward becoming multinational corporations, the PRC should consider establishing more comprehensive package agreements that incorporate the liberalization of services and investment.
- To address the concerns of firms, more effort should be made to improve the assistance available for making the best use of the FTAs signed. Special programs and institutions should be developed to provide FTA-related information, training, and consulting services for the PRC's business community. The Ministry of Commerce, the China Council for the Promotion of International Trade, and the China Chamber of International Commerce should conduct more thorough surveys on the impacts of FTAs with a special focus on business responses. The institutions most sought out by firms in need of FTA-related assistance were the Ministry of Commerce (among government agencies) and the Chamber of Commerce (among non-government agencies). An electronic information exchange and sharing mechanism should be built by these two bodies in order to maximize the utilization of services provided by both the public and private sectors. Finally, market-based service firms should also be encouraged.



- The multi-layered FTAs that crisscross East Asian markets seem to run counter to the dynamics of the existing production network in which the region's economies are embedded. The ideal solution would be to promote a region-wide FTA in East Asia. However, given the difficulty in reaching a consensus among East Asian countries, it would be more practical to promote a facilitation agreement that starts with a single initiative such as the mutual recognition of standards, the harmonization of ROOs, or the adoption of ROO guidelines in FTA negotiations in East Asia or APEC.

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