

# The Possibility of a Free Trade Area between China and the EU

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**Abstract:** *Since the establishment of bilateral relations with China, the EU is China's largest trading partner, export market and source of technology introduction. In addition to the high-level economic and trade dialogue, China and the EU also have dialogue mechanisms such as the Mixed Committee on Economic and Trade, trade policy, intellectual property rights and competition policy. With the development of economy and the progress of the times, the relations between China and the EU should also have further changes, and the establishment of a free trade area is just around the corner. The next five years will be a formative period for China's large market of service consumption and a reshaping of the European Union's long-term growth drivers. Based on the economic development status of China and the European Union, this paper analyzes the significance and existing problems of the establishment and concludes that China has the conditions to establish a free trade area with the European Union, and China and the European Union also have the intention to establish a free trade area. The advantages of establishing a free trade area outweigh the disadvantages, so the feasibility of establishing a free trade area between China and the European Union is very large in the next 5-10 years.*

**Keywords:** *Free trade area; European Union; Feasibility*

## 1. Introduction

Building pilot free trade zones is an important strategic measure to promote reform and opening up in the new era. Since the official establishment of China (Shanghai) Pilot Free Trade Zone on September 29, 2013, the development of China's pilot Free trade Zone has entered its tenth year.<sup>[1]</sup> The establishment of free trade zones has brought great convenience to China's import and export trade, and has increased the friendly exchanges between China and other countries while promoting economic development. Since 2019, the EU's perception and policies towards China have undergone significant changes, and China-Eu relations have entered a stage of continuous adjustment.<sup>[2]</sup> The establishment of a free trade area with the EU has long been China's intention. If the free trade area is successfully established, China will further expand its market in Europe, attract more foreign investment, and its diplomatic relations with EU countries will be stable.

## 2. Current situation and future development

### 2.1. Chinese Current situation and future development

As one of the most important indicators in the system of national economic accounting, Gross Domestic Product (GDP) can be used as a barometer to reflect the overall economic situation of a country or region and the implementation effect of government policies. In the early two months of 2022, thanks to strong resilience, the Chinese economy has generally operated within a reasonable range. Since the beginning of March, there have been some changes in the international and domestic environment that exceed expectations, and downward pressure on economic growth has increased further.

Although China overtook Japan to become the world's second largest economy in terms of total size as early as 2010, per-capita income in China, compared with developed countries, is still low.

2021 is the opening year of the 14th Five-Year Plan. In the face of the complex and severe situation

in the 21st century, where the spread of the COVID-19 pandemic has fluctuated, global industrial and supply chains have been impacted, and economic recovery has fluctuated, China has coordinated corona-virus prevention and control with economic and social development. With the overall stability of epidemic prevention and control, major new achievements have been made in economic and social development.

China's contribution to world economic growth has reached about 25 percent, down from over 30 percent in previous years, but it still contributes one quarter of the total, playing the role of a "locomotive" driving world economic growth.

At present, the world situation is evolving in a complex way. The recent outbreak of COVID-19 in China and some unexpected factors have exceeded expectations have created considerable downward pressure on the economy.

The next five years will be a formative period for China's large market of service consumption and a reshaping of the European Union's long-term growth drivers. The consumption structure of Chinese residents is transforming from material consumption to service consumption. The proportion of service consumption of urban residents will continue to rise, and the proportion in some developed areas may be even higher.

And the next five to ten years will be a golden era for China's economy. The average growth rate of China's economy will reach 5 to 6 percent. The appreciation of the RMB will continue and the economy will grow faster than America's.

## ***2.2. The Eu's Current situation and future development***

On May 16, 2022, the European Commission announced that it had cut its forecast for Eurozone growth in 2022 by 1.3 percentage points to 2.7% and raised its inflation forecast by 3.5 percentage points to 6.1%.

After being hit by the corona virus pandemic in 2020, Eurozone economic activity rebounded strongly from the spring of 2021. After a historic recession in which GDP fell by 6.4%, the Eurozone economy recorded a record growth of 5.4% in 2021, which helped salvage the 2022 figures. European Economic Commissioner Paolo Gentiloni indicates that without the impact of a strong rebound in 2021, growth in 2022 will not exceed 0.8%.

The commission expects gross domestic product in the euro area and the European Union to grow by 2.3% by 2023, with inflation falling to 2.7% and 3.2%, respectively. Paolo Gentiloni explained that rising prices of raw material have extended beyond energy to food prices, the prices of some industrial goods and even the prices of services. International conflicts have also added to supply chain problems, creating more uncertainty for businesses and households.

## ***2.3. Relations between China and the European Union***

Since the Belt and Road Initiative was proposed in 2013, China has actively promoted bilateral and multilateral trade and free trade and made significant progress. At the same time, it launched free trade negotiations with the EU and other countries, and got a certain response.<sup>[3]</sup>

Since the establishment of bilateral relations with China, the EU has become the largest trading partner of China, export market and source of technology import. In addition to the high-level economic and trade dialogue, China and the EU also have dialogue mechanisms such as the Mixed Committee on Economic and Trade, trade policy, intellectual property rights and competition policy.

On the one hand, China's direct investment in the EU has boosted the local economic growth of the EU. On the other hand, it will provide more job opportunities. More importantly, China's direct investment has brought momentum to the local development of the EU, which not only stimulates the sense of competition of local enterprises, but also helps local enterprises to promote development through innovation.<sup>[3]</sup>

According to a research report, in the current context of rising global uncertainties, it is more important for China and the EU to think about how to comprehensively deepen bilateral economic relations. Increase trade and investment activities between China and the EU and with third parties, promote cooperation on some fields, example climate change, energy, environment and global governance, and promote collaboration on all-round scientific and technological innovation,

infrastructure, financial services and personnel exchanges. Not only will opportunities and benefits reach young people, small businesses and ordinary people, but they will also drive economic growth, create jobs and improve economic and social welfare at home and around the world.

In view of both opportunities and challenges, the study acknowledges that China and the EU have differences in history, culture, development stage and economic system, and hopes that the both sides can enhance mutual trust and communication in free and fair trade, two-way investment and market access, so as to create a favorable business environment for enterprises.

### **3. The theory of Free Trade Area**

A Free Trade Area is a group of countries or regions that have signed free trade agreements. Member countries that have signed free trade agreements have eliminated tariffs and quantitative restrictions on trade in goods with each other, so that goods can flow freely between member countries.

Free trade zones allow foreign ships to enter and exit freely, foreign goods to import duty-free, and cancels the quota control of imported goods. Free trade zone is also a further extension of free port and a country's special functional area which is opening to the outside world.

In addition to most of the characteristics of free ports, free trade zones can also attract foreign capital to set up factories, develop export processing enterprises, allow and encourage foreign capital to set up large commercial enterprises, financial institutions and so on to promote comprehensive and comprehensive economic development in the zones.

The limitation of free trade zones is that they may lead to distortions in the flow of goods and tax avoidance. If not supplemented by other measures, the third countries are likely to ship goods to the member States of the integration organization with lower tariffs or trade barriers at first, and then transfer the goods to the member States with higher trade barriers. In order to avoid the distortion of commodity flow, free trade area organizations all have formulated the Principle of Origin, stipulating that only the products of origin, where the free trade area member countries are, can enjoy the free trade treatment given by the member countries. The meaning of the Principle of Origin indicates a certain exclusivity of the free trade area to non-member countries.

### **4. Analysis of the possibility of establishing a Free Trade area between China and the EU**

#### ***4.1. The benefits of establishing free trade zones***

First, establishing free trade zones helps to expand exports. After the establishment of the free trade area between China and the EU, Chinese products and services can enjoy smooth access to the market of EU countries and circulate sales in them under the condition of zero tariff, quota exemption and further improvement of other market access conditions, which helps to expand China's exports.

Second, establishing free trade zones helps to reduce consumer spending and producers' costs. With zero tariffs on a large number of products in the zone, domestic consumers can buy high-quality consumer goods from abroad at cheaper prices. In addition, companies can import raw materials, components and equipment at lower prices, greatly reducing costs for producers, which in turn can lower the prices of consumer goods. To some extent, it also can reduce consumer spending.

Third, establishing free trade zones will help attract foreign investment and undertake international industrial transfer. If we establish a free trade area with the EU, more EU countries will be attracted to invest in China to set up factories, and the products produced by their factories in China can be freely exported to other EU countries and even other countries that have established free trade areas with China.

Fourth, it will be helpful to improve our country's industrial manufacturing level and science and technology level. The EU is one of the world's major knowledge production centres, producing nearly a third of the world's output.<sup>[4]</sup>After the establishment of the free trade area with the EU, more and more advanced technologies and equipment will be introduced into our industrial production as EU countries invest and build factories in our territory, which will greatly promote the improvement of our industrial manufacturing level and scientific and technological level, and promote the development and innovation of our science and technology. The COVID-19 pandemic has posed severe challenges to China in the new era. Increasing and deepening cooperation in science and technology innovation

between China and the EU can solve the bottleneck problem of industrial construction, improve the level of scientific and technological innovation in China, and build China's dream of becoming a world scientific and technological power.<sup>[4]</sup>

Fifth, establishing free trade zones can promote the level of welfare in our country to improve. With the establishment of the free trade zone with the EU, a large number of enterprises will be attracted to invest in our country and set up companies and institutions in our country, which will certainly produce a large number of labor demand. To a certain extent, it can ease the employment pressure and narrow the gap between the rich and the poor in our country. Moreover, with the continuous influx of capital from European Union countries, our economic standard will be improved, and the coverage of national education and health care will be expanded.

Sixth, establishing free trade zones can increase political mutual trust. On the one hand, the establishment of the China-Eu Free Trade Area has opened the window of exchanges between China and EU countries. China has opened its door to the EU to export Chinese products, which has led to closer ties with EU countries, mutual trust and friendship between China and many other countries. On the other hand, the establishment of the China-Eu Free Trade Area has eliminated confrontation and conflict between trading countries and enabled them to trust each other and reach cooperation through trust. Through trade exchanges in the Free trade area, China and EU countries have left a good impression on each other, supported each other in international affairs and won recognition and praise from more countries.

Finally, establishing free trade zones makes the economy more dynamic. The establishment of a China-Eu free trade area means that all EU countries can trade with China. Through tangible material transactions, it can promote the development of the domestic real economy and transform material into assets. International trade in goods can promote the development of various industries in various countries, sell products, obtain funds, and eventually turn into gross domestic product. By utilizing the advantages of the free trade zone, we can realize the international transaction of financial assets, create the value of intangible assets, and finally obtain high profits.

## ***4.2. Existing problems***

### ***4.2.1. The EU has offered a high price for market access***

The EU requires China to further remove restrictions on access to certain industries, such as foreign share limits, joint venture forms, business scope limits, quantity requirements, localization requirements, licensing, standard differences, administrative measures, nationality requirements, lack of mutual recognition agreements, prohibitions, national security reviews and so on.

In the ongoing negotiations on the China and Eu Investment Treaty, the EU side not only calls for the introduction of the concept of non-discriminatory market access restrictions, but also demands that the length of the negative list be reduced as much as possible, allowing only a very limited number of industry exceptions.

If we accepted, it will test China as much as it did when it joined the World Trade Organization.

### ***4.2.2. China and the EU differ greatly on the issues of fair competition and state-owned enterprises***

The inclusion of competition policy issues in a Free Trade Agreement (FTA) usually reflects the high level of the agreement, but it relates to the order of competition in each country's domestic market, beyond the border measures covered by an average level FTA.

At present, it is difficult to bridge the differences between China and Europe on the issue of state-owned enterprises mainly lies in the discriminatory constraints on state-owned enterprises. China is concerned that the EU imposes separate constraints on state-owned enterprises by establishing bilateral and multilateral rules. China is willing to resolve issues related to fair competition through consultations under international multilateral frameworks. For example, we are currently conducting consultations with the EU on subsidies and other issues under the WTO framework, but we oppose factual discrimination caused by differences in ownership.

### ***4.2.3. The European side's demand for sustainable development is too advanced***

General provisions on labour and environmental standards, such as the commitment of both sides to promote sustainable environmental and labour development through trade, greater transparency and public participation in the formulation of relevant policies, cooperation in law enforcement and

compliance with international obligations, are not inconsistent with China's policies. But the EU's demands for a separate dispute settlement mechanism for labour and the environment, for example, which are clearly outside China's development stage.

#### **4.2.4. The EU is unwilling to give up the "surrogate country" approach of trade remedies against China**

Previously, because of the existence of Article 15 of China's accession protocol, it is easier for the EU to impose anti-dumping measures against Chinese products. After the expiration of this clause, the EU adopted new anti-dumping legislation to replace the concept of Market Economy Status with Market Distortion, so as to continue to use the practice similar to "surrogate country" in the future anti-dumping practice, to ensure that the calculation of dumping margin can continue to refer to the price and cost of the third country or even the EU. It can be expected that after the implementation of the new anti-dumping Act of the European Union, the judgment criteria of Market Distortion will certainly become an important weight for the EU to implement anti-dumping against Chinese exports in the future.

## **5. Conclusion**

First of all, since the establishment of diplomatic ties with the EU, the economic and trade relations between China and the EU have developed steadily and rapidly, and great achievements have been made in the cooperation in the fields of investment and science and technology. Economic complementary, political trust and the rapid growth of China's economy have provided a sound foundation for the development of bilateral economic and trade relations. Therefore, China has the conditions to establish a free trade area with the EU. And both China and the EU have the intention to do so. The current development status of China can generally meet the requirements of the free trade partner who sought by the EU. The establishment of the free trade area will bring benefits to EU countries, so the EU is willing to negotiate with China to establish the free trade area.

And secondly, based on the above analysis, it is found that the China-EU free trade area can significantly promote the economic growth and economic welfare of China and Europe, improve bilateral trade and its dependence, help to give play to comparative advantages, and promote the profound adjustment of the industrial structure of China and Europe. In addition, the China-EU free trade area will significantly influence the flow and pattern of global trade and help promote global trade opening and economic integration. Therefore, the establishment of a free trade area will bring great benefits to China. Although it is difficult for us to meet the requirements of the EU and we will face many difficulties in the process of negotiating the establishment of the free trade area, these problems will be solved in the next few years with the development of the Chinese economy.

After weighing the pros and cons, it is very likely that China and the EU will establish a free trade area in the next five to ten years.

Before that, however, China needs to resolve problems in the negotiation process and minimize the appearance of unfavorable clauses proposed by the EU. At the same time, China should improve its comprehensive strength to control more say.

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