

Free Trade as a Force of Political Stability? The Case of Mainland China and Hong Kong

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Abstract

Is free trade a force of political stability? This article argues that, while political stability could be a cause, it is not always a consequence of free trade. To test this argument, the article analyses the political causes and consequences of the external and internal trade liberalisation initiatives of Mainland China and Hong Kong through a selection of their current and proposed free trade agreements and free trade zones, namely, the Mainland and Hong Kong Closer Economic Partnership Arrangement, China-Japan-Korea Free Trade Agreement, Hong Kong Free Port, and China (Shanghai) Pilot Free Trade Zone. Together, these initiatives comprise a

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uniquely outlier case study on individual customs territories in a common state jurisdiction with contrary political economies. This article concludes that the effectiveness of free trade as a force of political stability is, by and large, more of a perception than a reality.

I. Introduction

Free trade increases wealth and reduces poverty, and, thus, it may contribute to social stability through the economics of comparative advantage.¹ Both the World Trade Organization (WTO) and World Bank suggest that trade liberalisation is a positive contributor to social stability.² The question that this article proposes to answer is whether free trade³ has a similar impact on

1. **Preferential Trade Agreements: A Law and Economics Analysis** (Kyle W. Bagwell & Petros C. Mavroidis eds., Cambridge Univ. Press 2011).

2. **Dan Ben-David, Håkan Nordström & L. Alan Winters, Trade, Income Disparity and Poverty** (WTO Publications 1999); David Dollar & Aart Kraay, *Growth Is Good for the Poor*, 7 **J. Econ. Growth** 195, 195-225 (2002); **Regional Trade Agreements and the WTO Legal System** (Lorand Bartels & Federico Ortino eds., Oxford Univ. Press 2006).

3. This article studies the relationship between free trade and political stability. For the purposes of the article, the concept of free trade takes two forms. One form is a free trade area inside which its component customs territories agree to remove substantially all barriers to trade among them. General Agreement on Tariffs and Trade 1994, art XXIV, WTO; Press Release, World Trade Organization, *Managing a World of Free Trade and Deep Interdependence* (Sept. 10, 1996). Another form is a free trade zone, where any goods imports are regarded, in relation to customs duties, as being outside the customs territory. 王孝松, 张国旺, 周爱农, [Wang Xiaosong, Zhang Guowang & Zhou Ainong], *上海自贸区的运行基础、比较分析与发展前景* [Operation Basis, Comparative Analysis and Future Prospect of Shanghai Pilot Free Trade Zone], 7 **经济与管理研究** [Res. on Econ. & Mgmt.] 52, 52-64 (2014).

political stability.⁴ The answer may help to explain the proliferation of Free Trade Areas (FTAs) and Free Trade Zones (FTZs) at a time when the need to avoid tariff barriers to trade is no longer much of a policy concern as well as help to inform how customs territories should make policy decisions in respect of free trade.⁵

While customs territories commit to free trade for a variety of reasons, it is questionable whether political considerations always play out in the way and to the extent that policy makers often claim.⁶ This article argues that political stability could be the cause of free trade but not necessarily the consequence of it. This article breaks down the question into two levels of governance: at the external level, whether FTAs promote political stability between or among the parties; and, at the internal level, whether FTZs promote political stability within that

4. As for political stability, this article considers the concept at two levels. Ermelinda Kanushi, On the Strong Influence of Political Stability on Corruption, (March 2012), http://www.academia.edu/9919504/On_the_Strong_Influence_of_Political_Stability_on_Corruption. At the internal level, the article makes reference to the World Bank indicator, which measures the level of political stability by popular perceptions of the likelihood that the government could be destabilized or overthrown by unconstitutional means, including politically-motivated violence and terrorism. Worldwide Governance Indicators, **World Bank**, <http://info.worldbank.org/governance/wgi/index.aspx#home>. At the external level, the article adopts a broader indicator that extends political stability to trust and security among states.

5. Jo-Ann Crawford & Roberto V. Fiorentino, The Changing Landscape of Regional Trade Agreements, **World Trade Org.** (2005), https://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf.

6. Ferdi De Ville & Gabriel Siles-Brügge, The Transatlantic Trade and Investment Partnership and the Role of Computable General Equilibrium Modeling: An Exercise in 'Managing Fictional Expectations', 20 **New Pol. Econ.** 653, 653–78 (2015).

jurisdiction.⁷ The unique relationship between Mainland China and Hong Kong – individual customs territories in a common state and their contrary political economies, one a socialist market economy, the other the freest market economy in the world – is the case study that documents the answer.

To determine whether political stability at the external level is achievable through the establishment of FTAs, this article starts with an analysis of the more notable political considerations that inform free trade.⁸ This analysis should help to delineate the fine line between cause and consequence. This article then identifies the political causes of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) and assesses the political consequences of its implementation. It moves on to discuss if there are any lessons to learn for future FTAs through an evaluation of the complex political relationships among the parties to the proposed China-Japan-Korea Free Trade Agreement (CJK FTA). At the internal level, this article discusses whether political stability is achievable through the establishment of FTZs. The long-established Hong Kong Free Port (HKFP) and the newly-established China (Shanghai) Pilot Free Trade Zone (SPFTZ) are the subjects of the discussion. Specifically, this article examines whether political stability was a cause at the time when these two FTZs came about, and even if

7. Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 *Int'l Org.* 427, 427–60 (1988).

8. **Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements** (Jagdish Bhagwati, Pravin Krishna & Arvind Panagariya eds., MIT Press 1999). An analysis of the political economy relationship between Macau and Mainland China and even that between Taiwan and Mainland China would add value to the case study but such Greater China relationship is outside the scope of this article.

political stability had not been a consideration, whether such a consequence follows. This article aims to become a reference for customs territories so that they make more effective and positive use of free trade policies – whether through the negotiation and conclusion of FTAs or the further development of FTZs – and, thereby, promote political stability.

II. External Political Stability and Free Trade Areas

This section of this article argues that, while most customs territories establish FTAs with political expectations, they do not always live up to them. In the context of CEPA, the claim that free trade is a force of political stability appears not demonstrable. As CEPA grows in width and depth, the peculiar relationship – close but distant – between Mainland China and Hong Kong is complicated by the lived experience of the agreement. It remains arguable whether the political fallout of free trade is always positive.⁹ This analysis attempts to shed light on the proposed CJK FTA, which is largely political in motivation.

There has been a rapid increase in the number of FTAs in recent years. From only about seventy in 1990, the number has increased to about 400 in 2016.¹⁰ On average, each WTO

9. Joanne Gowa & Edward D. Mansfield, *Power Politics and International Trade*, 87 *Am. Pol. Sci. Rev.* 408, 408–20 (June 1993).

¹⁰ *World Trade Report 2011: The WTO and Preferential Trade Agreements: From Co-Existence to Coherence*, **World Trade Org.** (2011), https://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report11_e.pdf; Joe Myers, *The World's Free Trade Areas – And All You Need to Know About Them*, **World Econ. Forum** (May 6, 2016), <https://www.weforum.org/agenda/2016/05/world-free-trade-areas-everything-you-need-to-know/>.

member is a party to thirteen FTAs.¹¹ In the past, customs territories entered into FTAs in order to avoid relatively high-applied most-favoured nation (MFN) tariffs. But, average applied MFN tariffs have since fallen markedly. Around half of all world trade is already subject to zero MFN tariff rates.¹² Accordingly, the comparative advantage that an FTA party would gain in the economic sense is not significant enough to explain the strength of interest in FTAs.¹³ The economic mission of FTAs has become secondary.¹⁴ After all, despite the expansion of FTAs, only 16 percent of global merchandise trade receives preferential treatment.¹⁵ It is apparent that non-economic motivations have become more and more significant as determinants of FTAs.¹⁶ Indeed, the World Bank attributes the expansion of regional trade blocs to political motives.¹⁷ This article, therefore, considers the political motives over and above the economic motives.¹⁸

11. World Trade Report 2011: The WTO and Preferential Trade Agreements: From Co-Existence to Coherence, **World Trade Org.** (2011), https://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report11_e.pdf.

12. Id.

13. 张玉环, 李巍 [Zhang Yuhuan and Li Wei], 自由贸易协定的政治经济学研究述评 [The Political Economy of Free Trade Agreements], 2 国际政治研究 [Int'l Pol. Study] 110, 110-28 (2014).

14. 马述忠, 刘文军 [Ma Shuzhong and Liu Wenjun], 双边自由贸易区热的政治经济学分析--一个新区域主义视角 [Political and Economic Analysis of the Rising of Bilateral Free Trade Areas – the New Regionalism Angle], 10 世界经济研究 [World Econ. Study] 48, 48–69 (2007).

15. World Trade Report 2011, supra note 11

16. Joost Pauwelyn, New Trade Politics for the 21st Century, 11 J. Int'l Econ. L. 559, 559–73 (2008).

17. Paul Collier, Maurice Schiff, Anthony Venables, & L. Alan Winters, Trade Blocs, **World Bank** (2000), https://hec.unil.ch/docs/files/21/280/1707_trade_blocs_-_a_world_bank_report_2000.pdf.

Political instability, which is seemingly an obstacle, actually induces FTA formation.¹⁹ According to the “end-game FTAs” theory, customs territories where government incumbents have shorter time horizons or face a higher probability of replacement are more likely to enter into FTAs.²⁰ Confrontational relationships between and among FTA parties may, in fact, work as an inducement for FTA formation.²¹ Thus, the early history of regionalism shows that the main objective of European economic integration was to prevent a new war in the continent; economic cooperation was the means to that end.²² But are these political motives really the cause or the consequence of free trade? Scholars have identified various political considerations by way of an explanation.

18. Giovanni Maggi & Andres Rodriguez-Clare, A Political-Economy Theory of Trade Agreements (Nat'l Bureau of Econ. Research, Working Paper No. 11716, 2005).

19. Marc D. Froese, Regional Trade Agreements and the Paradox of Dispute Settlement, 11 **Manchester J. Int'l Econ. L.** 367, 367–96 (2014).

20. Lorenzo Rotunno, Political Stability and Trade Agreements: Evidence for ‘End-Game FTAs’ (Sept. 2012), http://www.uni-heidelberg.de/md/awi/peio/rotunno_30.09.2012.pdf.

21. Liu Xuepeng & Emanuel Ornelas, Free Trade Agreements and the Consolidation of Democracy (Ludwig-Maximilians Univ., Working Paper No. 4103, 2013).

22. Lee Chang Jae et al., Rationale for a China-Japan-Korea FTA and Its Impact on the Korean Economy, (Korea Inst. for Int'l Econ. Policy 2005).

Numerous are the studies that identify the specific political considerations that a customs territory takes into account when contemplating trade negotiations.²³ There is a fine line, however, between the political cause and the political consequence of an FTA, a difference that studies have seldom addressed.²⁴ Political motives may be more accurately regarded as a consequence rather than a cause of free trade.

Studies observe that smaller customs territories aim to gain a heavier weight in the negotiation of trade deals with other customs territories by signing FTAs with larger customs territories.²⁵ Rather than a cause, this observation may be more precisely described as a consequence. If it were indeed a cause, it would explain the rationale behind smaller customs territories signing

23. Csilla Bartók & Sébastien Miroudot, The Interaction Amongst Trade, Investment and Competition Policies (Organisation for Econ. Co-operation & Dev., Trade Policy Working Paper No. 60, 2008); Wei Dan, China's Regional Trade Agreements: Implications and Comments, 6 *Manchester J. Int'l Econ. L.* 81, 81–118 (2009).

24. **David Gantz, Regional Trade Agreements: Law, Policy and Practice** (Carolina Acad. Press 2009); **Bilateral and Regional Trade Agreements: Case Studies** (Simon Lester & Bryan Mercurio eds., Cambridge Univ. Press, 2009). See, in particular, Erik Gartzke, Quan Li & Charles Boehmer, Investing in the Peace: Economic Interdependence and International Conflict, 55(2) *International Organization* 391, 391-438 (2001); Patrick J. McDonald, Peace through Trade or Free Trade?, 48(4) *J. of Conflict Resolution* 547, 547-572 (2004); Jong-Wha Lee & Ju Hyun Pyun, Does Trade Integration Contribute to Peace?, 24 *Asian Development Bank Working Paper Series on Regional Economic Integration* (2009); Havard Hegre, John R. Oneal & Bruce M. Russett, Trade Does Promote Peace: New Simultaneous Estimates of the Reciprocal Effects of Trade and Conflict, 47(6) *J. of Peace Research* 763, 763-774 (2010).

25. Peter Drahos, When the Weak Bargain with the Strong: Negotiations in the World Trade Organization, 8 *Int'l Negot.* 79, 79–109 (2003).

FTAs with larger customs territories, but not the reverse, as trade liberalization creates both “winners” and “losers.”²⁶

Other studies suggest that, from time to time, customs territories enter into FTAs in order to acquire the kind of experience that will permit them to form more complex and important FTAs in the future. For example, CEPA, signed in 2003, was thought to be a testing ground for the SPFTZ and Economic Cooperation Framework Agreement (ECFA) between Mainland China and Taiwan.²⁷ The SPFTZ and ECFA happened more than a decade after the conclusion of CEPA.²⁸ It would be somewhat unfair to say that Mainland China had consciously intended, at the time that it negotiated CEPA, to acquire experience for the establishment of the latter two FTAs. It may be fairer to say that CEPA has laid down the foundation for the further liberalisation of trade as a consequence or derived benefit.²⁹

26. Willian R. Golden Jr., The Politics of Free Trade: The Role of Trade Adjustment Assistance, 14 *Va. J. Int'l L.* 151, 151–69 (1973).

27. Chen Ping-Hsun, Cross-Straits Economic Cooperation Framework Agreement, Cross-Strait Agreement on Intellectual Property Right Protection and Cooperation, and Implications of One-China, 36 *Hous. J. Int'l L.* 59, 59–99 (2014).

28. Id.

29. Wang Wei, CEPA: A Lawful Free Trade Agreement under ‘One Country, Two Customs’ Territories, 10 *L. & Bus. Rev. Am.* 647, 651 (2004).

Studies further observe a certain unique objective that Mainland China may have, distinct from other customs territories.³⁰ Showing “big country morality” (taking less from and giving more to smaller FTA partners) could be one such distinctive motive.³¹ This observation, however, fails to explain the proliferation of FTAs in general. It also does not make sense to claim that any given customs territory, let alone Mainland China, enters into FTAs in a wholly selfless act. The reality is that a customs territory may take less in a certain aspect and take more in other aspects; and, if the customs territory has indeed taken less from a particular FTA, it will naturally attempt to take more in another FTA.³²

On balance, then, the above observations may simply be rhetoric for customs territories to justify an FTA when its economic performance has fallen short of expectations. The next section shall discuss the fine line between political causes and consequences and put that discussion in the context of CEPA.

A. MAINLAND CHINA AND HONG KONG CLOSER ECONOMIC PARTNERSHIP ARRANGEMENT

Commentators agree that the establishment of CEPA was political in motivation. Media reports at the time suggested that the Central People’s Government (CPG) was seeking to boost

30. Wang Chao, China’s Preferential Trade Remedy Approaches: A New Haven School Perspective, 21 *Asia Pac. L. Rev.* 103, 103–18 (2013).

31. Yang Jiang, China’s pursuit of free trade agreements: Is China exceptional?, 17 *Rev. Int’l Pol. Econ.* 238, 238–61 (2010).

32. Golden Jr., supra note 26, at 151-69.

the economic development of Hong Kong and, in turn, promote its political stability; CEPA was the chosen strategy.³³

Mainland China and Hong Kong signed CEPA in 2003. CEPA was the first ever trade pact signed by Hong Kong, the freest economy in the world, and also Mainland China, now the second largest economy in the world.³⁴ It is, then, necessary to examine the political causes of CEPA and whether CEPA has actually promoted political stability.

After more than a decade since its entry into force, there is a sense that the economic benefits that CEPA has brought to Hong Kong fall short of expectations.³⁵ For example, the equity control and entry threshold provisions to set up financial institutions are too stringent.³⁶ And, despite the special liberalisation measures applicable to Guangdong, approvals from the authorities at different levels of government are necessary to establish businesses in that province

33. 《明年1月1日起700種零關稅港貨感京城》 [700 types of zero tariff goods from Hong Kong exported to the Mainland from 1 January next year], **People Daily**, Dec. 10, 2004, <http://www.people.com.cn/BIG5/jingji/1047/3047531.html>; See also Gonzalo Villalta Puig, *A Quasi-adjudicative Dispute Settlement Mechanism for CEPA: The Rule of Law in Trade Relations between Mainland China and Hong Kong*, 12 **Chinese J. of Int'l. L.** 281, 281–320 (2013).

34. Peter Chiu, *CEPA: A Milestone in the Economic Integration between Hong Kong and Mainland China*, 15 **J. Contemporary China** 275, 275–95 (2006).

35. Jiayang Hu, *Closer Integration, Controversial Rules: Issues Arising from the CEPA between Mainland China, Hong Kong, and Macao*, 18 **Pace Int'l L. Rev.** 389, 389–406 (2006).

36. 劉建黨 [Liu Jiandang], 《論粵港服務業市場准入制度銜接》 [On Connection of Entry Criteria of Service Markets between Guangdong and Hong Kong] 1 **開放導報** China Opening J. 84–87 (2013).

and their efficiency is often not satisfactory.³⁷ In addition, Hong Kong's legal practitioners experience difficulties in passing Mainland China's National Judicial Examination due to the obvious difference in legal systems.³⁸

While the economic impact of CEPA has been widely discussed (and challenged), its political impact has drawn much less attention.³⁹ This lack of attention may be due to the fact that the political objectives of CEPA are not expressly stated.⁴⁰ As set out in its Preamble, CEPA was signed “[t]o promote the joint economic prosperity and development of the Mainland and the Hong Kong Special Administrative Region [(HKSAR)] . . . [and] to facilitate the further development of economic links between the two sides and other countries and regions.”⁴¹ There is no explicit mention anywhere in the main text about the promotion of political stability. Neither do the Objectives and Principles touch on this point.⁴² This article shall, first, identify the political objectives of CEPA, which, while they may not appear in the text, have been

37. Id.

38. Zhao Yun, Liberalization of Legal Services under the CEPA Framework between Mainland China and Hong Kong, 38 **Legal Issues of Econ. Integration** 321, 321–39 (2011).

39. Wei Dan, supra note 23.

40. See id.

41. Committee on Regional Trade Agreements, Mainland and Hong Kong Closer Economic Partnership Arrangement, WTO Doc. WT/Reg162/1 (June 23, 2003) [hereinafter Hong Kong CEPA].

42. Id.

acknowledged by the authorities; and, secondly, this article will examine whether, after more than a decade of implementation, the outcomes measure up to the expectations.

1. Political Causes

The CPG has long held the assumption that economic prosperity entails political stability.⁴³ Members of the Communist Party of China put much emphasis on the concept of xian fu qi lai (to get rich first).⁴⁴ It is a traditional Asian belief that to increase economic interdependence is the best way to increase regional security.⁴⁵

Democratic governments commonly use FTAs as a signalling device to show voters that they are indeed implementing sensible policies.⁴⁶ This signalling device, however, also functions in non-democratic governments, including Mainland China. Mainland China conducts its FTA policy on a gradual and progressive approach.⁴⁷ Earlier on, it was common to observe Mainland China conclude a trade in goods agreement and, years later, follow it with the conclusion of a trade in services and investment agreement. This observation leads to a very important question

⁴³ Wang Wei, supra note 29, at 651.

⁴⁴ Id. at 649.

⁴⁵ Int'l F. for Trilateral Cooperation [IFTC], Unity in Diversity – Fostering East Asian Identity & Spirit of Community, (Final Outcome Report, Trilateral Cooperation Secretariat, 2014).

⁴⁶ World Trade Report 2011, supra note 11.

⁴⁷ 'Joint Report and Policy Recommendations on the Possible Roadmaps of a Free Trade Agreement between China, Japan and Korea' (Trilateral Joint Research Paper, Development Research Center of China, National Institute for Research Advancement of Japan and Korea Institute for International Economic Policy of Korea, 2008).

about Mainland China's real objectives behind its signature of FTAs: what matters, the substance or the sign?

In the case of CEPA, Mainland China signed the deal both to show the world the successful implementation of the "One Country, Two Systems" principle and to show the people of Hong Kong that their motherland is sincere in its commitment to support them, especially during difficult times.⁴⁸ CEPA is the first FTA signed by Hong Kong; it is also the first FTA signed by Mainland China.⁴⁹ It is without precedent in the sense that it is a bilateral accord between a region (Hong Kong) and the country to which it belongs (Mainland China).⁵⁰ It is, in sum, a sign to attest that the all-important "One Country, Two Systems" principle and Hong Kong's autonomy in external trade relations, both with the guarantee of Hong Kong's Basic Law, are indeed real.⁵¹ After all, the "One Country, Two Systems" principle and other relevant provisions of the Basic Law made the conclusion of CEPA possible.⁵² With this legal backing, Hong Kong

⁴⁸ Wang Wei, supra note 29, at 651.

⁴⁹ Id.

⁵⁰ Id.

⁵¹ See id. at 647–666; Michael C. Davis, The Basic Law and Democratization in Hong Kong, 3 *Loy. U. Chi. Int'l L. Rev.*, 165, 165–85 (2006).

⁵² The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, (promulgated by Order No. 26 of the President of the People's Republic of China, April 4, 1990, effective July 1, 1997), art. 116 (China). [hereinafter HKSAR Basic Law] ("The Hong Kong Special Administrative Region shall be a separate customs territory. The Hong Kong Special Administrative

could sign CEPA as an individual customs territory. This act symbolically reinforces the autonomy of Hong Kong after reunification.

Taiwan may indeed be the jurisdiction to which the Chinese authorities are most eager to show that the principle of “One Country, Two Systems” produces significant benefits.⁵³ This principle was originally put forward by the then paramount leader, Deng Xiaoping, as the basis for a peaceful settlement to the dispute over Taiwan’s reunification with Mainland China.⁵⁴

The conclusion of CEPA confirmed that the CPG would support Hong Kong in times of difficulty. Former Premier of the State Council, Wen Jiabao, made it clear that as well as being intended to boost the economy, CEPA “indicates the [CPG]’s concern and support for Hong Kong.”⁵⁵ It shows that the maintenance of prosperity and, thereby, political stability remains the essential objective of Mainland China’s policy towards Hong Kong. CEPA articulates the desire

Region may, using the name ‘Hong Kong, China’, participate in relevant international organizations and international trade agreements (including preferential trade arrangements)...”).

53. Jeanette Yuen, The Myth of Greater China? Hong Kong as a Prototype of Taiwan for Unification, 5 **Taiwan in Comparative Perspective** 134, 134–52 (2014); Albert Chen, A Tale of Two Islands: Comparative Reflections on Constitutionalism in Hong Kong and Taiwan, 37 **H.K. L. J.** 647, 647–88 (2007).

54. Wen Qing, One Country, Two Systems”: The Best Way to Peaceful Reunification, 26 **Beijing Rev.** (May 26, 2009), http://www.bjreview.com.cn/nation/txt/2009-05/26/content_197568.htm.

55. Gary Cheung, Beijing Fails to Win Hearts and Minds of Hongkongers with CEPA Trade Pact, **S. China Morning Post**, (July 5, 2013), <http://www.scmp.com/business/economy/article/1275470/beijing-fails-win-hearts-and-minds-hongkongers-cepa-trade-pact>.

of Mainland Chinese authorities to make Hong Kong benefit from Mainland China's economic growth.⁵⁶

Some commentators even suggest that, more than a gift in the wake of the Severe Acute Respiratory Syndrome (SARS) outbreak and the Asian financial crisis of 1997, CEPA was a ploy to win the hearts and minds of Hongkongers.⁵⁷ Apart from easing the anxieties of Hong Kong people about the future of their region as a bridge between Mainland China and the rest of the world, CEPA seeks to win over the people of Hong Kong to the CPG's conservative approach to constitutional reform.⁵⁸

Quite a number of scholars have challenged the economic benefits allegedly brought by CEPA to Hong Kong as its trade concessions have little practical effect.⁵⁹ While tariffs on goods exports to Mainland China from Hong Kong have certainly been reduced to zero, the significant difference in land and labour costs between Mainland China and Hong Kong outweigh the tariff benefits.⁶⁰ The negligible manufacturing base of Hong Kong has restricted the impact of this

56. Bruno Cabrillac, A Bilateral Trade Agreement Between Hong Kong and China: CEPA, 54 **China Perspectives** (July-Aug. 2004) <http://chinaperspectives.revues.org/3002>.

57. Cheung, supra note 55.

58. Peter Cheung, Toward Collaborative Governance between Hong Kong and Mainland China, 52 **Urban Studies** 1915, 1915–33 (2015).

59. Cabrillac, supra note 56.

60. Steve Ching, Hsiao Cheng & Wan Shuiki, Impact of CEPA on the Labor Market of Hong Kong, 23 **China Econ. Rev.** 975, 975–81 (2012).

concessionary measure.⁶¹ It is in this light that CEPA is thought to be a merely political gesture intended to project the image that the Mainland Chinese authorities share a commitment to Hong Kong's prosperity.

When CEPA was signed, both parties had committed to extend the arrangement by phases.⁶² CEPA has been rolling out in an incremental manner ever since. As the scope of CEPA constantly expands, it provides an opportunity for people across the border to dialogue and, thereby, strengthen emotional ties. Ten supplements have been concluded in the ensuing years with the latest one, Supplement X, signed in August 2013. In November 2015, a new agreement was signed under the framework of CEPA to further enhance the liberalisation of trade in services in both breadth and depth, including the extension of the majority of Guangdong pilot measures to the whole of Mainland China.⁶³

2. Political Consequences

The overarching purpose of CEPA is to promote political stability by facilitating integration between Mainland China and Hong Kong.⁶⁴ An FTA could indeed be politically driven but may fail to perform what it was expected to do. Thus, by analysing the mismatch between cause and

61. Cheung, *supra* note 55.

62. John Wong & Zhang Yang, Hong Kongs CEPA with China: Round Two, 4 *China: An Int'l J.* 114 (2006).

63. Press Release, New agreement signed under framework of CEPA to basically achieve liberalisation of trade in services between the Mainland and Hong Kong (Nov. 27, 2015), available at <http://www.info.gov.hk/gia/general/201511/27/P201511260681.htm>.

64 See id.

consequence, it is possible to test whether CEPA is still a pragmatic and appropriate vehicle for Mainland China and Hong Kong to achieve their respective political goals.

The HKSAR Government acknowledges that CEPA has become a sign of its successful return to Mainland China in 1997 under the principle of “One Country, Two Systems.”⁶⁵ It is the first case anywhere of a region signing a trade deal with its own state.⁶⁶ This unprecedented arrangement is only possible because Hong Kong is a separate customs territory and both Mainland China and Hong Kong remain separate members of the WTO.⁶⁷

While the local government has long trumpeted the successful achievement of this signalling goal, the people of Hong Kong have a different opinion. According to a poll conducted by the University of Hong Kong’s Public Opinion Programme (HKU POP), the rate of people’s confidence in the “One Country, Two Systems” principle was 45.5 percent in July 1997, when sovereignty was handed over.⁶⁸ That rate dropped to 10.6 percent in June 2003, when CEPA

⁶⁵ Chinese State Council white paper on ‘One Country, Two Systems’ policy in Hong Kong, **S. China Morning Post** (June 10, 2014), <http://www.scmp.com/news/hong-kong/article/1529167/full-text-practice-one-country-two-systems-policy-hong-kong-special>.

⁶⁶ Zhang Liang, Unprecedented RTA Practices between the Customs Territories of China, 4 **J. of E. Asia and Int’l L.** 81, 82 (2011).

⁶⁷ Press Release, Happy Economic Returns after 10 years of CEPA (Sept. 2, 2013), available at <http://www.info.gov.hk/gia/general/201309/02/P201309020603.htm>.

⁶⁸ People’s Confidence in “One Country, Two Systems” (per poll) (6/1993 – 3/2016), http://hkupop.hku.hk/chinese/popexpress/trust/conoacts/poll/conoacts_poll_chart.html (last visited June 26, 2016).

was signed.⁶⁹ Though it climbed to 60.8 percent in April 2008, it dived to -18.7 percent in September 2014, only days before the commencement of the “Occupy Movement” protests.⁷⁰ The situation has improved a year later but the rate still remains a negative figure (-7.9 percent in March 2016).⁷¹ The people of Taiwan, which have closely followed recent political developments in Hong Kong, also cast doubt on the viability of the principle.⁷²

The additional liberalisation measures that came with every new supplement and agreement under CEPA and the more frequent people-to-people contact that came with its Individual Visit Scheme (IVS) sought to demonstrate the Mainland Chinese support for Hong Kong. This symbolic outreach did achieve a measure of social stability in the first few years after the entry into force of CEPA.⁷³ In the initial years at least, CEPA did appear successful in fostering Hong Kong people’s emotional attachment to Mainland China.⁷⁴ The goodwill did not last long, however. More than twelve years after its signature, the economies of Mainland China and

⁶⁹ Id.

⁷⁰ Id.

⁷¹ Id.

⁷² Bevin Chu, Two Systems and Taiwan Consciousness, **Dateline Taipei** (Mar. 4, 2015), <http://datelinetaipei.blogspot.hk/2015/03/one-country-two-systems-and-taiwan.html>.

⁷³ Takayuki Takeuchi, Integration under ‘One Country, Two Systems’— The Case of Mainland China and Hong Kong (Inst. of Developing Econ., Japan External Trade Org. (JETRO), Paper No. 70, 2006), available at <http://econpapers.repec.org/paper/jetdpaper/dpaper70.htm>.

⁷⁴ Li Yuanyuan & Feng Bangyan, Effect, Problems and Trend of CEPA, 6 **J. of Jinan Univ.** 57, 57–63 (2007).

Hong Kong are certainly much more intertwined, but tension between the two sides seems to be on the rise.

According to HKU POP, 40.3 percent of respondents interviewed in June 2003, right before CEPA was signed, said that they trusted the CPG.⁷⁵ The figure rose to 59 percent in October 2007.⁷⁶ But it dropped to 27.1 percent in June 2016.⁷⁷ The level of trust in the CPG has dropped below the rate recorded right before CEPA was signed in spite of the rising trend evident initially.

A couple of days after CEPA was signed, half a million Hongkongers protested in opposition to the planned national security law under Article 23 of the Basic Law.⁷⁸ It has since become an annual practice for the Hong Kong people to take to the streets on the first of July. According to HKU POP, the number of participants in this protest dropped to its lowest point in 2008 with around 17,500 people and then climbed again to approximately 160,000 people in 2014.⁷⁹

⁷⁵ People's Trust in the Beijing Central Government (per poll) (12/1992 – 8/2016).

https://www.hkpop.hku.hk/english/popexpress/trust/trustchigov/poll/trustchigov_poll_chart.html (last visited September 13, 2016).

⁷⁶ Id.

⁷⁷ Id.

⁷⁸ John Chan, Huge rally in Hong Kong against anti-subversion laws, **World Socialist Web Site** (July 8, 2003),

<https://www.wsws.org/en/articles/2003/07/hoko-j08.html>.

⁷⁹ Combined charts of the July 1 Rally over the years (2003–2014), http://hkpop.hku.hk/english/features/july1/chart/july1count_chart.html (last visited July 6, 2016).

The IVS was introduced in July 2003 as a liberalisation measure under CEPA. IVS allows the residents of selected cities in Mainland China to visit Hong Kong individually, without joining tour groups. Visitors from Mainland China have significantly boosted the business of retailers, restaurants, and hotels, a boost which was especially welcome in such difficult times for Hong Kong as the SARS outbreak in 2003 and financial tsunami in 2009. The number of Mainland Chinese residents visiting Hong Kong has been on a steep rise.⁸⁰ In 2002, before the launch of the IVS, Hong Kong received around 7 million Mainland Chinese visitors.⁸¹ In 2009, the CPG allowed residents with Shenzhen household hukou registration to apply for a multiple entry visa, in a move to give greater convenience to their leisure trips to Hong Kong.⁸² In 2013, the figure soared to 41 million.⁸³ The trend has continued progressively with 47 million Mainland Chinese visitors travelling to Hong Kong in 2014.⁸⁴ Over the last couple of years, the people of Hong Kong, while acknowledging that the local economy has improved with the implementation of

⁸⁰ **World Tourism Org.** (UNWTO), Growth of Chinese Tourists to Hong Kong, China, 2002 to 2014 18-19 (2015).

⁸¹ Id.

⁸² Legislative Council Secretariat, Individual Visit Scheme (Legislative Council Commission, Research Brief No. RBO6/13-14, 2014), available at <http://www.legco.gov.hk/research-publications/english/1314rb06-individual-visit-scheme-20140507-e.pdf>.

⁸³ UNWTO, supra note 80.

⁸⁴ Id.

CEPA, have complained that the region has become overly reliant on Mainland China.⁸⁵ There is a view that, while IVS has certainly benefited the Hong Kong economy, the mass influx of Mainland Chinese visitors has disrupted the receptive capacity of Hong Kong, particularly the disruption caused by parallel trading activities.

Parallel traders purchase their supplies in Hong Kong, which offers a lower cost and a supposedly higher quality than those found in Mainland China, and take them across the border in small quantities. This practice has been a key factor in the growing anti-Mainland Chinese sentiment in Hong Kong. The people of Hong Kong complain about crowded public transportation and facilities, rising prices, and the changing face of traditional neighbourhoods.⁸⁶ For example, the number of shops selling cosmetics and personal care products surged by 1,500 percent between 2004 and 2013.⁸⁷

The HKSAR Government has approached with special care the parallel trading of powdered formula for infants as this practice has led to a critical shortage in certain brands for local mothers.⁸⁸ To solve this problem, the Food and Health Bureau of Hong Kong instigated a law in

85. Wei Jingjian & Wang Xiaolin, On the Nature, Effectiveness and Dispute Settlement Model in CEPA, 3 **Contemporary L. Rev.** 122, 122-26 (2004).

86. Julianna Liu, Hong Kong tensions rise over 'parallel traders', **BBC News** (July 1, 2014), <http://www.bbc.com/news/business-28093730>.

87. Legislative Council Secretariat, supra note 82.

88. Press Release, Amendment Regulation to regulate export of powdered formula gazette (Feb. 22, 2013), available at <http://www.fhb.gov.hk/gia/general/201302/22/P201302220597.htm>.

2013 to prohibit the export of infant powdered formula without a licence.⁸⁹ Any person who contravenes the relevant provisions shall be guilty of an offence and liable on conviction for a fine of HKD 500,000 and to imprisonment for two years.⁹⁰

Apart from the practice of parallel trading activities, the practice of Mainland Chinese women giving birth in Hong Kong through illicit means has also provoked much concern among locals. The Hong Kong Immigration Department has prosecuted more than 100 Mainland Chinese women for giving birth in Hong Kong illegally.⁹¹ They were all convicted and sentenced up to fifteen months imprisonment.⁹² These legislative measures and prosecution actions have, inevitably, elevated political tension at the border.

In early 2015, there were multiple protests across Hong Kong against parallel traders from Mainland China. Numerous demonstrators attempted to overrun some of the shopping malls frequented by Mainland Chinese visitors in Hong Kong. They wore masks and walked through the shopping malls chanting slogans, such as “go back to China.”⁹³ As the quarrels eventually

⁸⁹ Id.

⁹⁰ Id.

⁹¹ **Immigration Department, Annual Report 2013** 19 (2013).

⁹² Id.

⁹³ Fresh protests against parallel traders, this time in Sha Tin, **ejinsight** (Feb. 16, 2015), <http://www.ejinsight.com/20150216-fresh-protests-against-parallel-traders/>.

turned physical, the police intervened with batons and pepper spray.⁹⁴ This kind of discontentment evidently puts the much sought after social order at risk.

To curb the parallel trading activities, the CPG endorsed a proposal by the HKSAR Government to replace the multiple entry visa with a one-trip-per-week permit.⁹⁵ The new policy was announced on April 13, 2015, the same day on which it came into effect.⁹⁶ This measure should lessen the impact of the substantial increase in visitor arrivals on affected districts in Hong Kong. All of these incidents suggest that the unrestricted expansion of the scope of CEPA could indeed become counter-productive to the task of building emotional ties.

B. CHINA-JAPAN-KOREA FREE TRADE AGREEMENT

The proposed CJK FTA is highly political in character. Similar to CEPA, the political causes of the proposed CJK FTA are apparent to all observers even though they have not been formally stated as such.⁹⁷ This article shall identify those political causes through an examination of the various announcements made by the authorities, comments made by scholars and the media, and actual political developments in the region. It is then followed by an evaluation of the likelihood

94. Id.

95. Press Release, One-trip-per-week cap welcomed (Apr. 13, 2015) available at http://www.news.gov.hk/en/categories/admin/html/2015/04/20150413_183004.shtml?pickList=ticker.

96. See id.

97. Srinivasa Madhur, China-Japan-Korea FTA: A Dual Track Approach to a Trilateral Agreement, 28 *J. of Econ. Integration* 375, 375-92 (2013).

that these causes could lead to their expected consequences drawing from the experience of CEPA.

China, Japan and South Korea have been studying the possibility of a tripartite FTA for many years. The three countries expect to achieve increased political stability, among other benefits, through greater economic interdependence.⁹⁸ The idea was first tabled at a regional summit in 1999.⁹⁹ Official negotiations launched in 2012.¹⁰⁰ It is worth noting that the estimated percentage growth in the Gross Domestic Product is not notable (from 0.3 percent of China to 2.8 percent of South Korea).¹⁰¹ It is, therefore, only fair to assume that there must be incentives beyond those that lie in the purely economic realm.

For decades, issues concerning Japan's wartime history and territorial tensions with China have dogged relations between what are Asia's two largest economies. In recent years, public

98. Gene M. Grossman & Elhanan Helpman, The Politics of Free Trade Agreements (Nat'l Bureau of Econ. Research, Paper No. 4597, 1993), available at <http://www.nber.org/papers/w4597.pdf>.

99. China-Japan-South Korea FTA accelerates as the TPP gains ever more momentum, **Promar Consulting** (Aug. 30, 2011), <http://www.promarconsulting.com/company-news/accelerated-cjk-fta-against-tpp-%e2%80%93-how-they-can-solve-the-agricultural-problem/>.

¹⁰⁰ Shannon Tiezzi, China-Japan-South Korea Hold FTA Talks Despite Political Tension, **The Diplomat** (Mar. 5, 2014), <http://thediplomat.com/2014/03/china-japan-south-korea-hold-fta-talks-despite-political-tension/>.

101. **Joint Report and Policy Recommendations on the Possible Roadmaps of a Free Trade Agreement between China, Japan and Korea**, supra note 47, 4.

sentiment towards each other appears to have worsened.¹⁰² There are unresolved historical issues between South Korea and Japan too.¹⁰³ As seen in the case of the European Union (EU), “overcoming political barriers by converting confrontational relationships into cooperative ones is an almost inevitable requisite for successful economic integration.”¹⁰⁴ It is believed that a trilateral FTA might ease the political tension.¹⁰⁵

1. Political Causes

Similar to CEPA, negotiations for the proposed CJK FTA started off with the aim to foster a closer neighbourly relationship among the parties.¹⁰⁶ The proposed CJK FTA also aims to counteract regional threats.¹⁰⁷ Customs territories primarily enter into FTAs in order to increase their market access, which encourages other customs territories to join the FTA race for fear of

102. Zhang Yunbi, Sino-Japanese ties have ‘opportunity’, **China Daily** (Dec. 4, 2014), http://english.gov.cn/news/international_exchanges/2014/12/04/content_281475019227816.htm.

103. Wang Shanshan & Qui Jiafeng, A Rationality Analysis of First Constructing China-South Korea Bilateral Free Trade Area, in 6 **Commercial Research, Sch. of Econ., Ne. Normal Univ.** 98, 98-103 (2014).

104. James H. Mathis, Regional Trade Agreements in the GATT/WTO: Article XXIV and the International Trade Requirement, (T.M.C. Asser Press 1st ed. 2002); Inkyo Cheong, Regional Integration in Northeast Asia: Present and Future 24 (Kor. Inst. For Int’l Econ. Policy, Working Paper No. 35, 2003).

105. Min-Hua Chiang, The Potential of China-Japan-South Korea Free Trade Agreement, 30 **E. Asia** 199 (2013).

106. Guiguo Wang, China’s FTAs: Legal Characteristics and Implications, 105 **Am. J. Int’l L.** 493 (2011).

107. Zhang Xiaotong et. al., The EU’s New FTA Adventures and Their Implications for China, 48 **J. of World Trade** 525 (2014).

being left behind.¹⁰⁸ Like falling dominos, FTAs beget more FTAs.¹⁰⁹ If two countries in a region of three enter into an FTA, the absent third country may be negatively affected by it due to the trade diversion effect.¹¹⁰

Two decades ago, East Asian countries were left behind in the global race for FTAs.¹¹¹ It was not until 1992 that the first FTA in Southeast Asia was concluded, namely, the Association of Southeast Asian Nations (ASEAN). Northeast Asia, though holding much greater economic power and trading volume, does not have a regional equivalent.

Apart from ASEAN, now there is the Trans-Pacific Partnership (TPP). After five years of talks led by the United States, the TPP negotiations concluded in October 2015. Japan and several other Asian customs territories are parties to it. China, however, is not one of them. If the proposed CJK FTA were not to eventuate, China would find itself at a comparative disadvantage in the region.¹¹² Certainly, the collective reluctance to lower and remove tariffs on

108. **Joint Report and Policy Recommendations on the Possible Roadmaps of a Free Trade Agreement between China, Japan and Korea**, *supra* note 47.

109. *See* WTO, *supra* note 3.

110. **Joint Report and Policy Recommendations on the Possible Roadmaps of a Free Trade Agreement between China, Japan and Korea**, *supra* note 47.

111. Youngmi Choi, Political Economy of Free Trade Agreements in China, Japan, and South Korea: Sectoral and National Security Politics of the FTA Wave (August 2013) (unpublished Ph.D. dissertation, University of Wisconsin-Milwaukee), <http://dc.uwm.edu/cgi/viewcontent.cgi?article=1249&context=etd>.

112. Edward D. Mansfield & Diana C. Mutz, *Support For Free Trade: Self-Interest, Sociotropic Politics, and Out-Group Anxiety*, 63 *Int'l Org.* 425 (2009).

agricultural goods is a major constraint for CJK FTA negotiators. But, as intra-regional trade in agricultural goods declines and tariffs progressively come down, agricultural concerns will become less of an impediment to the proposed CJK FTA if, that is, the ambitious TPP approach to the liberalisation of trade in rice and other agricultural goods is anything to go by.¹¹³ The TPP contains many provisions that are unacceptable to China, such as the strict regulation of state-owned enterprises, more rigorous intellectual property rights protection, and stringent labour and environmental standards. While China is uncomfortable with Japan's participation in the TPP, it is nevertheless keen to forge ahead with its own trade negotiations with Japan and its other East Asian trading partners, through the proposed CJK FTA.¹¹⁴

China, Japan, and South Korea all acknowledge the need to strengthen Asia's northeast identity. As part of its overall policy for economic development and regional cooperation through the "Belt and Road" initiative, the proposed CJK FTA has been high on the agenda of the CPG.¹¹⁵ Premier of the State Council, Li Keqiang, has publicly indicated his wish to establish the largest FTA in East Asia through an accord with Japan and South Korea.¹¹⁶ Japan

113. China-Japan-South Korea FTA accelerates as the TPP gains ever more momentum, *supra* note 99.

114. Gilbert Rozman, Asia's Slippery Slope: Triangular Tensions, Identity Gaps, Conflicting Regionalism, and Diplomatic Regionalism, and Diplomatic Impasse Toward North Korea, 25 *Joint U.S.-Korea Acad. Studies* 187 (2014).

115. Michael Schuman, China's New Silk Road Dream, *Bloomberg* (Nov. 25, 2015, 9:33 AM), <http://www.bloomberg.com/news/articles/2015-11-25/china-s-new-silk-road-dream>.

116. H.E. Li Keqiang, Premier, State Council of China, Enhance ASEAN Plus Three Cooperation at the 17th ASEAN Plus China, Japan, and ROK Summit (Nov. 14, 2014), available at http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/zyjh_665391/t1212272.shtml.

and South Korea are equally eager. South Korea has even expressed the hope that the proposed CJK FTA would lead to the development of a supranational organisation in Northeast Asia on a par with ASEAN and, ideally, the EU.¹¹⁷ The tenth round of negotiations was held in June 2016.

Functionalist scholars suggest a policy spillover effect that would incrementally drive integration away from trade integration (“low politics”) to political integration (“high politics”).¹¹⁸ On this basis, they rate highly the political significance of negotiations for the proposed CJK FTA, because a trade deal could enhance cooperation with adjacent countries and, thereby, settle down recent instability in Northeast Asia.¹¹⁹

Scholars further suggest that an FTA would help to promote a community consciousness within Northeast Asia and harmonise the political systems of the three countries. The premise is that increased economic exchanges between countries can deter war as they become interdependent.¹²⁰ Closer economic relations under the proposed CJK FTA should enhance regional stability, even if the agreement is solely focused on trade. It would still help to build political trust, strengthen non-governmental exchanges, and deepen bonds of friendship among the peoples of the three countries.¹²¹

117. IFTC, *supra* note 45.

118. Cheung, *supra* note 55.

119. Chiang, *supra* note 105.

120. Lee et al., *supra* note 22.

121. Yu Lintao, *Three's Company China, South Korea and Japan Consider Free Trade Agreement*, **Beijing Review** (May 21, 2012), http://www.bjreview.com.cn/special/2012-05/21/content_469723.htm.

A former Minister of Foreign Affairs of the Republic of Korea, Kim Sung-hwan, said in a keynote speech at the International Forum for Trilateral Cooperation in 2014 that South Korea attached great importance to what he called trustpolitik and that his country hoped to build a “framework for . . . cooperation . . . as a way of easing tensions and building up trust.”¹²² China too recognises that continuous dialogue on the basis of respect for historical truth and international law is an effective means to peacefully settle disputes among countries, whether they are over territorial sovereignty or maritime rights and interests.¹²³ Premier Li has underlined the importance of maintaining regional stability and cooperation in Northeast Asia. Apart from revealing his high hopes that the proposed CJK FTA would become an instrument for the promotion of regional stability and integration, he has appealed for support from the Philippines and other neighbouring countries to carry out practical cooperation initiatives in relevant fields and move steadily towards the goal of building an East Asian community.¹²⁴

2. Political Consequences

A complete draft of the proposed CJK FTA is not yet publicly available. Therefore, it is hard to estimate how the conclusion of such an agreement could counteract the TPP. Commentators suspect that negotiations for the proposed CJK FTA are likely to simply mimic those for the

122. IFTC, supra note 45.

123. Keiqiang, supra note 116.

124. Id.

TPP.¹²⁵ In a sense, the proposed CJK FTA, or more accurately the negotiation of it, seems to be no more than a gesture by the Chinese authorities to neutralise the diplomatic fallout from the TPP.¹²⁶

Nevertheless, the mere fact that talks are taking place is sufficient to suggest a measure of progress.¹²⁷ A commitment to open dialogue may be the very approach that ultimately achieves the political objectives behind the proposed CJK FTA, over and above the conclusion of a trade deal. The establishment of joint institutions may be more necessary than the removal of trade barriers in terms of building regional cooperation and fostering a spirit of neighbourhood in Northeast Asia amidst its turbulent political currents.¹²⁸

The call for trade creation may, in fact, just be a convenient pretext for the authorities to encourage the citizenry, especially through the media, to focus on the political economy of the region, rather than dwell on the kind of counterproductive discourse that does nothing but irritate national sensitivities over painful historical and territorial disputes. Negotiations for the

125. Jing Li, Tough Times Ahead for China-Japan-South Korea Joint FTA, **E. Asia Forum** (Dec. 6, 2014), <http://www.eastasiaforum.org/2014/12/06/tough-times-ahead-for-china-japan-south-korea-joint-fta/>.

126. See Angelika Rettberg et al., Rights, Free Trade, and Politics: the Strategic Use of a Rights Discourse in the Negotiation of Free Trade Agreements 81 **Colombia Int'l** 129 (Apr. 24, 2014), https://colombiainternacional.uniandes.edu.co/datos/pdf/descargar.php?f=./data/Revista_No_81/n81a07.pdf.

127. Li, supra note 116.

128. **Trilateral Cooperation Secretariat, International Forum for Trilateral Cooperation 2014: Final Outcome Report**, (Apr. 15, 2014), http://file.tcs-asia.org/file_manager/files/tcs/publication/forum/IFTC%202014%20Final%20Outcome%20Report.pdf.

proposed CJK FTA provide, then, a diplomatic platform in optimistic anticipation that, one day soon, the trilateral relationship may reach a turning point when a new generation of leaders takes charge.¹²⁹ Despite these good intentions, their effect is not altogether obvious. The trilateral relationship between China, Japan and South Korea is still at a relatively low point. The ties among these three countries are very much vulnerable to any reckless actions by leading political figures.

Negotiations for the proposed CJK FTA are not yet close to conclusion. It is, therefore, premature to evaluate its potential political effect. Notwithstanding, having regard to the progress of negotiations to date, it may be overly optimistic or even naïve to expect that the formation of a regional trade area could bring a solution to the problematic politics of Northeast Asia.¹³⁰ Qu Xing, President of the China Institute of International Studies, was right to say that the issues between China and Japan are deep-seated and would “take quite a long time to deal with.”¹³¹ Any improvement in the trilateral relationship that the prospective conclusion of a trade agreement brings could be sabotaged simply with a visit by Japan’s Prime Minister to the Yasukuni Shrine, which pays homage to war criminals. It may not be wise to overestimate the political force of an FTA, which is a lesson learned from the experience of CEPA.

129. *Id.*

130. See Wang Jiangyu, *China’s Regional Trade Agreements: The Law, Geopolitics and Impacts on the Multilateral Trading System*, 8 *Singapore Year Book of Int’l L. (SYBIL)* 119 (2004), <http://www.commonlii.org/sg/journals/SGYrBkIntLaw/2004/7.pdf>.

131. Yunbi, *supra* note 102.

Another notable point is that, despite the political issues, China and Japan have, in recent years, maintained a buoyant bilateral trade relationship worth in excess of USD 300 billion and more than five million people visit each other's country annually.¹³² It is possible that the territorial disputes and the proposed CJK FTA could co-exist in two parallel universes.¹³³

Ultimately, the future of the proposed CJK FTA will depend on the many collateral problems that the three countries face in finalising the agreement. 2015 marked the 70th anniversary of the end of World War II. Will Japan ever take steps to show remorse and achieve real reconciliation with its Asian neighbours? If this gesture ever happens, the need for a trade deal would probably become less urgent.

It is commonly believed that customs territories enter into FTAs with a view to promote political stability.¹³⁴ But there is a fine line between cause and consequence. Despite good intentions – or simply wishful thinking – the consequence does not always follow on from the cause. The assumption all long upheld by the Mainland Chinese authorities that the maintenance of Hong Kong's prosperity would win over Hong Kong's affection and, thereby, bring about political stability is worth reconsidering. The unlimited expansion of an FTA could, ultimately,

132. *Id.*

133. Hosuk Lee-Makiyama, *Desert Island FTAs: How the CJK Agreement and the Territorial Dispute Actually Co-Exist*, *Eur. Centre for Int'l Pol. Econ.* (Dec. 4, 2013), <http://ecipe.org/blog/desert-island-ftas-how-the-cjk-agreement-and-the-territorial-dispute-actually-co-exist/>.

134. See Colin Crawford, *Some Thoughts on the North American Free Trade Agreement, Political Stability and Environmental Equity*, 20 *Brook. J. Int'l L.* 585 (1995).

become detrimental to the promotion of political stability. The case of the proposed CJK FTA is on point.

III. Internal Political Stability and Free Trade Zones

At the internal level, this article examines, in the context of Mainland China and Hong Kong, whether there is a political cause for customs territories to open up trade through the establishment of FTZs. By considering whether the HKFP serves as an effective and positive force of internal political stability, it attempts to shed light on the Mainland China's recently launched SPFTZ, and, in turn, determine whether a similar political stabilising effect can come of it.¹³⁵ This article argues that trade openness does not necessarily entail internal political stability; other institutional factors, such as respect for human rights and fundamental freedoms under the rule of law, carry significant weight.¹³⁶ This observation leads to the conclusion that it may not be wise for customs territories to form FTZs merely for political purposes as trade liberalisation may only be one of the many factors that contribute (and not always effectively or positively) to internal political stability.

In 17th century Northeast Asia, it was a common belief that an isolationist policy was the best measure to maintain domestic political stability. From the Ming dynasty to the early Qing dynasty, the Chinese government imposed a ban on foreign exchange in line with its feudal

135. See Lu Xia, *The Development Process, Functional Evaluation, and Implications of World Free Trade Zones*, 5 *World Rev. of Pol. Econ.* 359, 359-71 (2014).

136. See James Rice, *Political Domination and the Rule of Law in Hong Kong*, 23 *UCLA Pac. Basin L.J.* 51 (2005).

regime; the Japanese and Korean governments adopted similar closed-door policies in the early Edo period and Joseon dynasty, respectively. Researchers call this period the sakoku or locked country period.¹³⁷ Hundreds of years have passed since then: Hong Kong and Mainland China have each joined the WTO. The WTO upholds a number of important principles, with openness and predictability being two of the fundamental ones.¹³⁸

A. HONG KONG FREE PORT

The British declared Hong Kong a free port more than 170 years ago upon the establishment of a Crown colony. It is still a free port. The Basic Law provides that Hong Kong shall remain a free port, a separate customs territory, and an international financial centre.¹³⁹ As Hong Kong's constitution, the Basic Law enshrines the principle of "One Country, Two Systems" as well as "a high degree of autonomy" for "Hong Kong People ruling Hong Kong."¹⁴⁰ Article 114 of the Basic Law states that Hong Kong shall maintain the status of a free port and shall not impose any

137. Zhang Xiaogang (张晓刚), Liu Qin (刘钦), & Wan Yingchen (万映辰), 锁国时期中日韩三国港口城市发展的政治背景微探 - 以17世纪的广州、长崎和釜山为中心 [Analysis on the Political Background of Port City Development of China, Japan and Korea in Sakaku Period – With Canton, Nagasaki and Busan As the Center in 17th Century], 27 **日本问题研究** [Japan Problem Studies] 32–39 (2013).

138. Joost Pauwelyn, New Trade Politics for the 21st Century, 11 **J. Int'l Econ. L.** 559 (2008).

139. **Xianggang Jiben Fa** arts. 109, 114, 116 (H.K.).

140. See **Michael Ramsden & Oliver Jones, Hong Kong Basic Law: Annotations and Commentary** (Sweet & Maxwell, 2010); See **Law of the Hong Kong Constitution** (Johannes Chan & C.L. Lim eds., Sweet & Maxwell, 2011).

tariffs, while Article 115 states that Hong Kong shall pursue a free trade policy and safeguard the free movement of goods, intangible assets, and capital.¹⁴¹

1. Political Causes

The function of the HKFP is clear. The HKFP was established to make it attractive for the world's economies to trade in Hong Kong, with Hong Kong, and through Hong Kong. More than just a gateway to Mainland China, Hong Kong has been a global business and financial centre, as well as a global aviation and logistics centre in Asia.¹⁴² It seems, then, that a political cause is not apparent in the establishment of HKFP. Even in the absence of manifest intent, the question remains: would political stability be a natural consequence of trade liberalization?

2. Political Consequences

Of the 194 customs territories surveyed in the World Bank's Political Stability Index (PSI), Hong Kong came 46th (0.88 points), several places after Singapore (7th) and Japan (35th), both comparable polities in Asia. Hong Kong's rating was slightly below the average value (0.92 points) over the period from 1996 to 2013.¹⁴³ Towards the end of 2014, Hong Kong experienced

141. **Xianggang Jiben Fa** arts. 114, 115 (H.K.).

142. Fan Hongyun (范宏云) & Sun Guangyong (孙光永), 香港建设自由贸易港的经验 [Experience of the Establishment of Hong Kong Free Trade Port], 3 特区实践与理论 [Practice and Theory of Special Economic Zones] 56–59 (2008).

143. Hong Kong: Political Stability, **TheGlobalEconomy.com**, http://www.theglobaleconomy.com/Hong-Kong/wb_political_stability/ (last visited June 29, 2016). The average Political Stability Index for 2013 was -0.05 points. The highest value was 1.45 points (New Zealand) and the lowest -2.75 points (Somalia).

the “Occupy Movement,” which saw large groups of protesters stage open air assemblies in a few key business areas of the city, demanding universal suffrage. The movement remained active for more than two months. Though the long-term impact on Hong Kong’s financial industry has yet to be assessed, businesspeople have expressed concern that the protests will inevitably dampen investors’ confidence in the Hong Kong business environment.¹⁴⁴

Apart from the PSI, the Corruption Perceptions Index (CPI) may be of some indicative value with respect to the political stability of a place because empirical results demonstrate that political stability is a determinative factor of corruption.¹⁴⁵ According to Transparency International’s CPI for 2014, of the 173 customs territories surveyed, Hong Kong came 19th after Singapore (7th) and Japan (15th). Though ranking close to the top tier, it is notable that, for the period between 2001 and 2014, Hong Kong hit its lowest point in 2014.¹⁴⁶ According to the HKU POP, Hong Kong people’s appraisal of corruption since the handover in 1997 also dropped to its lowest point in 2014.¹⁴⁷

144. Shirley Yuen, *Time To End the Occupy Movement and Let Life Get Back to Normal*, **CEO Online - Hong Kong General Chamber of Commerce** (Oct. 9, 2014), http://www.chamber.org.hk/en/about/hkgcc_ceo-blog_detail.aspx?ID=138.

145. Kanushi, *supra* note 4; See **Ronald MacDonald & Muhammad Tariq Majeed, Causes of Corruption in European Countries: History, Law, and Political Stability** (Univ. of Glasgow, 2011), http://www.gla.ac.uk/media/media_218412_en.pdf.

146. **Corruption Perceptions Index 2014: Results, Transparency Int’l**, <https://www.transparency.org/cpi2014/results> (last visited Jul. 7, 2016). The average Corruption Perceptions Index for 2014 was 43.36 points. The highest value was 92 points (Denmark) and the lowest 8 points (North Korea).

147. **Appraisal of Degree of Corruption-Free Practices, HKU POP**, https://www.hkupop.hku.hk/chinese/popexpress/socind/socq50/poll/socq50_poll_chart.html (last visited Jul. 7, 2016).

Apart from the PSI and CPI, there are other institutional factors – human rights and fundamental freedoms, the rule of law, or the simplicity of the tax regime – that shed light on the domestic political stability of any given jurisdiction. In the Fraser Institute’s index for 2014, which measures economic freedom, size of government, legal structure and security of property rights, access to sound money, freedom to trade internationally, and commercial regulations, Hong Kong ranked first, while Mainland China ranked 115th.¹⁴⁸ Similarly, Hong Kong people’s appraisal of other rights and freedoms guaranteed by the Basic Law, including freedom of speech, press, or religious belief, is on a relatively steady trend upwards since the handover in 1997.¹⁴⁹

Hong Kong people’s confidence in their region’s future rose sharply from 36 percent before CEPA (February 2003) to 62.4 percent half a year after CEPA was signed (February 2004). But the confidence level has since dropped to 44 percent, as shown by a survey conducted in September 2015.¹⁵⁰ Additionally, Hong Kong people’s appraisal of compliance with the rule of

148. See James Gwartney, Robert Lawson & Joshua Hall, Fraser Inst., *Economic Freedom of the World* (2014), <http://www.freetheworld.com/2014/EFW2014-POST.pdf>.

149. Rating of Freedom Indicators Combined Charts, HKU POP, https://www.hkupop.hku.hk/chinese/popexpress/freeind/overall/poll/overall_poll_chart.html (last visited Jul. 7, 2016).

150. People’s Confidence in HK’s Future, HKU POP, https://www.hkupop.hku.hk/chinese/popexpress/trust/conhkfuture/poll/hk_poll_chart.html (last visited Jul. 7, 2016).

law and the degree of prosperity has been on a relatively stable trend throughout the years, averaging between six and seven out of ten.¹⁵¹

Though there have been changes throughout the years, Hong Kong is still considered to be at a satisfactory level in terms of political stability.¹⁵² It is, however, worth noting that, this relatively stable environment is not solely attributable to the establishment of a free port and the maintenance of the world's freest economy. Other institutional strengths, as well as people's perceptions towards them, should not be overlooked.¹⁵³

B. CHINA (SHANGHAI) PILOT FREE TRADE ZONE

Evidencing Mainland China's commitment to an open global economy, Premier Li said at the 2015 annual meeting of the World Economic Forum that "[i]n a world facing a volatile economic situation, we should all work to promote opening-up and innovation. We need to act along the trend of our time, firmly advance free trade, resolutely reject protectionism, and actively expand regional economic cooperation."¹⁵⁴

151. Appraisal of Degree of Compliance with the Rule of Law, **HKU POP**, http://hkupop.hku.hk/chinese/popexpress/judiciary/socq44/poll/socq44_poll_chart.html (last visited Jul. 7, 2016); Appraisal of Degree of Prosperity, **HKU POP**, http://hkupop.hku.hk/chinese/popexpress/socind/socq47/poll/socq47_poll_chart.html (last visited Jul. 7, 2016).

152. See Yash Ghai, Hong Kong's New Constitutional Order (Hong Kong Univ. Press, 2d ed. 1999).

153. Sun Li Zhou (孙力舟), Free Port Policy – The Secret of Our Success (自由港政策--香港成功的重要秘诀) 23 **Pol'y Res. & Exploration** 12, 72-73 (2013).

154. Li Keqiang, Premier of China's State Council, Uphold Peace and Stability, Advance Structural Reform and Generate New Momentum for Development, Special Address at the World Economic Forum Annual Meeting (Jan. 21, 2015).

Further to that commitment, Mainland China launched the SPFTZ on September 29, 2013. The General Plan prescribes the design and function of the SPFTZ,¹⁵⁵ while the Regulations cover related topic areas such as foreign investment, trade in financial services, and taxation in the SPFTZ.¹⁵⁶ The SPFTZ specifically provides for business registration, a negative list for foreign investment, measures to facilitate customs clearance, and rules to boost financial liberalisation.¹⁵⁷

1. Political Causes

In addition to the SPFTZ's core mission to promote trade within the area, it has other functions to perform.¹⁵⁸ First, the SPFTZ serves as a testing ground to propel Mainland China's economic liberalisation.¹⁵⁹ The expectation is that, within two to three years, the SPFTZ will pioneer the

155. General Plan for the China (Shanghai) Pilot Free Trade Zone (SPFTZ) (中国 (上海) 自由贸易试验区总体方案) (promulgated by the St. Council, Sept. 27, 2013).

156. Regulations of China (Shanghai) Pilot Free Zone (中国 (上海) 自由贸易试验区条例) (adopted at the 14th Session of the Standing Committee of the 14th Shanghai Municipal People's Congress of Shanghai, Jul. 25, 2014), available at <http://en.shftz.gov.cn/Government-affairs/Laws/General/319.shtml> (last visited Jul. 7, 2016).

157. See Zhu Yingping, On the Legal Measures of the Reform and Opening-up in China (Shanghai) Pilot Free Trade Zone, 2 **J. Shandong U. Sci. & Tech.** 37 (2015).

158. Yao Daqing & John Whalley, The China (Shanghai) Pilot Free Trade Zone: Background, Developments and Preliminary Assessment of Initial Impacts 2-15 (National Bureau of Economic Research, Working Paper No. 20924, 2015).

159. Pan Chengrong, Achievements and Problems of Reform of Investment Management System for Shanghai Pilot Free Trade Zone, 6 **Asian Agricultural Research** 30, 30 (2014); Zhu Jing-an & Liu Xue-wen, The Effect of Shanghai Pilot Free Trade Zone on China's Related Economic Legal System Transformation, 4 **J. Pol. Sci. & L.** 25 (2014).

implementation of innovative ideas so as to form a “duplicable and replicable experience” that will lay the groundwork for a new round of reforms of the Mainland Chinese economy.¹⁶⁰ Secondly, the SPFTZ delivers a message to the world: that Mainland China shall forge ahead with economic liberalisation and further open up to world markets.¹⁶¹ Premier Li said, a year after the launch of the SPFTZ, “[t]he more open China is, the more it values its friendship and cooperative relations with other countries; the more developed China grows, the greater contribution it will make to world peace and prosperity.”¹⁶² This statement sums up the CPG’s expectations for the SPFTZ. Thus, similar to the HKFP, it seems that a political cause is not immediately apparent from the establishment of the SPFTZ. Would political stability be a natural consequence of trade liberalization?

2. Political Consequences

In the World Bank’s PSI for 2013, Mainland China received a negative rating. It ranked 140th (-0.55 points), below North Korea (139th) but above the Philippines (161st), and Thailand

160. Zheng Wan, Yang Zhang, Xuefeng Wang, & Jihong Chen, Policy and Politics Behind Shanghai’s Free Trade Zone Program, 34 **J. Transport Geography** 1 (2014).

161. Billy Wong, The Shanghai Free Trade Zone: The Opportunities and Challenges for Hong Kong, **HKTDC Research** (Dec. 17, 2013), <http://hong-kong-economy-research.hktdc.com/business-news/article/HK-Mainland-Taiwan-Relations/The-Shanghai-Free-Trade-Zone-the-opportunities-and-challenges-for-Hong-Kong/rp/en/1/1X47QY0I/1X09VNPE.htm>.

162. Li Keqiang, Premier of China’s State Council, Speech at the First Plenary Session of the Tenth ASEM Summit in Milan (Oct. 16, 2014).

(177th), all close neighbours. The rating was slightly below the average value (-0.46 points) over the period from 1996 to 2013.¹⁶³

Turning to the corruption index, the Central Commission for Discipline Inspection (CCDI) of the Communist Party of China launched an anti-corruption campaign at the end 2012.¹⁶⁴ On April 8, 2014, the CCDI launched a new section on its website that invites the public to report cases of corruption and misconduct. A “weekly report” system now names – and shames – government officials who have breached the relevant rules and guidelines. It is the first time that a Mainland Chinese authority reports such cases publicly.¹⁶⁵ This initiative is a notable improvement in transparency standards.

Despite these anti-corruption drives, Mainland China shows a downward trend in Transparency International’s CPI in 2014 (thirty-six points) in comparison to 2013 (forty points).¹⁶⁶ The catching “tigers and flies” (public officials) actions have certainly had a visible impact. But it is important that Mainland China remains vigilant against corruption in all its

163. China: Political Stability, **The Global Econ.**, http://www.theglobaleconomy.com/China/wb_political_stability/%3E/ (last visited June 21, 2016).

164. No Ending for CPC Anti-Corruption War, **News of the Communist Party of China** (Apr. 25, 2014), <http://english.cpc.people.com.cn/206972/206974/8609981.html>.

165. Beijing, Shanghai Disciplinary Watchdogs Report Misconduct Cases, **News of the Communist Party of China** (Apr. 25, 2014), <http://english.cpc.people.com.cn/206972/206974/8610003.html>.

166. Corruption Perceptions Index 2014: Results, **Transparency Int’l**, <https://www.transparency.org/cpi2014/results> (last visited June 21, 2016).

forms, however subtle. Commentators argue that recent prosecutions are merely efforts to clamp down on political opponents as distinct from genuine anti-corruption measures.¹⁶⁷

Political instability is the key determinant of corruption. Corruption is a deep-seated problem for Mainland China and it may be overly optimistic to expect that the introduction of trade liberalization alone would be enough to solve the problem. As is the case in Hong Kong, other institutional strengths (such as the rule of law or human rights and fundamental freedoms) contribute to relatively low corruption levels and a politically stable environment. The SPFTZ is new and its political effects are yet to emerge and so, for now at least, the effect of this measure as a force of political stability should not be overrated.¹⁶⁸

IV. Conclusion

This article has argued that political stability can certainly be a cause of free trade but not necessarily its consequence. At the external level, the article has analysed CEPA and the proposed CJK FTA. With respect to CEPA, the expected positive impact on emotional affinity has not eventuated. As the scope of the agreement expands, issues, such as the mass influx of Mainland Chinese visitors to Hong Kong, continually come up that erode the goodwill built in

167. Srirak Pliapat, Asia Pacific: Growing Economies, Growing Corruption, *Transparency Int'l* (Dec. 3, 2014), <http://blog.transparency.org/2014/12/03/asia-pacific-growing-economies-growing-corruption>.

168. Yao Daqing & John Whalley, An Evaluation of the Impact of the China (Shanghai) Pilot Free Trade Zone (SPFTZ) (National Bureau of Economic Research, Working Paper No. 20901, 2015).

the early years of the trade relationship.¹⁶⁹ With respect to the proposed CJK FTA, the historical disputes between China, Japan, and South Korea are too intricate for a mere trade agreement to effectively settle. While a trade agreement might indeed promote political stability, any measure of goodwill could vanish with a high-profile reckless stance. As for its potential to counteract regional threats, until such time as the content of the agreement becomes public, the proposed CJK FTA may be little more than a corollary of the TPP's "catfish effect."¹⁷⁰

At the internal level, no specific political objective is discernible in the establishment of either the HKFP or the SPFTZ, but because the consequence of free trade matters more than its cause, this article has discussed domestic political stability in both Mainland China and Hong Kong. In general, Hong Kong is politically stable, but its trade openness is only one of the many factors that contribute to this state of affairs. Institutional strengths such as respect for human rights and fundamental freedoms under the rule of law play a lead role. Amongst other measures, Mainland China has to step up its efforts to combat corruption.

This article concludes then that, while free trade can certainly be a force of political stability, whether its performance meets expectations is less than certain. The strength of free trade as a force of political stability should not be overrated. It may be more prudent to regard free trade as an intended force of political stability. In conclusion, it is time for states and other customs

169. Craig Shepherd & Nicky Cardno, *New Opportunities in Hong Kong – The Impact of the CEPA*, 31 *Int'l Bus. Law.* 265 (2003).

170. Ding Yifan, *The "Catfish Effect" in the International Financial System*, *China US Focus* (May 8, 2015), <http://www.chinausfocus.com/finance-economy/the-catfish-effect-in-the-international-financial-system>.

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territories to reassess the cost effectiveness of FTAs and FTZs as instruments of political stability.