The Trans-Pacific Partnership: Perspectives from China

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Abstract: With multilateral negotiations on free trade at a stand-still, all eyes are on further regional integration. By far the most important regional project lies in the Pacific, with the US led Trans Pacific Partnership (TPP). If concluded, the TPP could establish an FTA spanning over forty percent of the global economy. Conclusion, however, is far from assured and subject to a number of uncertain variables, the most vexing of which is the role of China. If China joins the TPP it will not only augment the potential gains of the partnership, it will likely tip the scales, in favor, for the current negotiating partners. If China remains outside the block, it will likely try to put pressure on the negotiating partners, or at least make it harder for the US to get agreement on existing terms, by offering attractive alternatives. China’s unclear trajectory is the motivation of our paper which asks, will China join the TPP? A number of prominent arguments and statements from high level officials suggest that China will indeed join the negotiations. However, in assessing each of these arguments in detail, we conclude that none are particularly robust and that China is unlikely to join the TPP negotiations, as it threatens to undermine both the political and economic reform strategy of the current administration. Instead, we predict that China will continue to promote constructive alternatives to the TPP, without directly challenging it, in the hope of delaying negotiations while maintaining good faith with the regional partners, including the United States.
Introduction:

On May 30, 2013, China’s Ministry of Commerce (MOC) drew headlines by announcing that it will “analyze the pros and cons as well as the possibility of joining the TPP, based on careful research and according to principles of equality and mutual benefit.”¹ This tedious statement dramatically changed the tone of TPP negotiations, which had previously been seen as an "anyone-but-China club" designed to contain the country’s growing economy.² As if to confirm such fears, US government officials frequently describe the TPP as a "centerpiece" and “pillar” in America’s pivot, or rebalance, towards Asia.³ Since May 2013, however, the White House has shifted rhetoric, now welcoming China into the TPP negotiations, should it choose to engage them. For example, Susan Rice, US National Security Advisor, argued that the US “welcomes any nation that is willing to live up to the high-standards of this agreement to join and share in the benefits of the TPP, and that includes China.”⁴

The prospect of a TPP that includes China has already inspired hopeful expectations on various sides of pacific. In the United States, prominent organizations like the US China Business Council and The Heritage Foundation have voiced their support for including China in the negotiations. Similarly, prominent Chinese scholars, like PKU’s Huang Yiping, argue that "an increasing number of policy advisers are now urging the government to apply to join the TPP negotiations as early as possible.”⁵ Justin Yifu Lin, former World Bank senior vice president, openly called for Beijing to participate in the TPP.⁶ Similarly, China’s new Central Bank chief economist, Ma Jun, has argued that the TPP could augment China’s GDP by up to two percent.⁷ Even an official from the Chinese Ministry of Commerce was quoted as saying, “We know it's difficult, but the key point is we have to change minds and stick to opening-up to the world. Once we are determined on the TPP, everything else will be solved.”⁸

But will China join the TPP? Proponents highlight three arguments for why China is likely to join. The first is the economic argument, which simply states that China’s gains from joining outweigh the costs of not joining. For example, proponents of this argument claim that, given China’s status as the dominant exporter in the region, it will benefit from lower tariff rates and avoid the costs of trade

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² China to study possibility of joining TPP: MOC “商务部：中方会认真研究分析加入 TPP 利弊和可能 available at: http://www.chinanews.com/gn/2013/05-30/4875990.shtml
³ see: (Gross 2013; Basu Das 2013; Shao 2013)
⁴ http://asiasociety.org/new-york/complete-transcript-thomas-donilon-asia-society-new-york
⁵ (Gordon 2014)
⁶ http://english.pku.edu.cn/weblmg/mediaimg/11144.htm
⁷ Ma’s projection should be seen as an upper bound as it assumes having 16 countries in the TPP including the additions of China, South Korea, Thailand and Indonesia. See: http://www.bloomberg.com/news/2014-06-24/pbochs-ma-urges-joining-tpp-to-boost-growth-report-shows.html
⁸ (Ding and Boris 2013)
diversion if it joins the TPP. The second argument concerns China’s international reputation as a constructive regional player and a dedicated free market promoter. According to the international diplomacy argument, China’s failure to join would undermine its reputation, giving regional economies further impetus for improving relations with the US instead. Moreover, proponents of the international diplomacy argument point out that, by joining negotiations now, China will have more leverage to negotiate its own terms than if it abstained and joined later, after the current members reach an agreement. Finally, proponents point to China’s domestic political environment, arguing that joining could help the current Xi administration push through declared reform objectives, much like WTO accession did for the previous Hu administration in the early 2000s.

In combination, the three arguments described above are compelling and suggest a clear TPP-bound trajectory for China. Individually, however, none is particularly robust. With respect to the economic logic, we show that the gains from trade, as well as the potential losses from trade diversion, are actually not that substantial. Regarding the international diplomacy argument, while we agree that joining negotiations now provides China more bargaining power than accession to a finished agreement in the future, we also point out that China has alternative means by which to influence the negotiations, namely by offering alternatives to the TPP. The Regional Comprehensive Economic Partnership (RCEP) and the long-delayed Asia-Pacific Free Trade Agreement (FTAAP), for example, are two key vehicles China is trying to maneuver in parallel to the TPP. While China stresses that “together the different arrangements contribute to common goal of ‘high quality’ free trade in the Asia Pacific,” it is difficult not to see the RCEP and the FTAAP as Chinese alternatives to the US-driven TPP. Moreover, we stress that, although China has an interest in projecting a market-friendly image, it is does not have an interest in joining an agreement not of its own making, especially not at a time when the leadership is trying to portray an image of a geo-politically resurgent China. Finally, with regards to domestic politics, we concede that joining the TPP would help the regime coordinate reform objectives. But, when we look at the actual reform strategies being employed by the current leadership, we find that comprehensive reform is not the goal, at least not right now. Instead, the push for localized Free Trade Zone’s (FTZs), such as the recently inaugurated Shanghai FTZ, suggests a more gradual and politically calculated strategy that would be undermined by TPP obligations.

The paper proceeds as follows. In section one, we review existing IPE and IR arguments on regional integration and how they apply to China’s relationship with the TPP. In section two, we address the economic rationale for China’s joining the TPP by assessing the benefits it would enjoy by joining the TPP and inferring the costs it would incur should it not join. In section three, we address the international

9 (Lee 2014)
diplomacy argument by juxtaposing the TPP against the RCEP and FTAAP trade arrangements, for which China has expressed strong support. In section four, we engage the domestic politics argument by evaluating China’s current reform strategy from both an economic and political perspective. Based on this three-part analysis, we conclude that that China is unlikely join the TPP. Instead, we argue that China will most likely continue promoting alternatives to the TPP in the hope of slowing down negotiations while maintaining good faith with the regional partners, in particular the United States. In section five, we summarize our logic and offer our predictions for China’s future involvement with the TPP and the various alternative regional trade arrangements.

I: The Political Economy of Regional Integration – China and the TPP

The TPP is billed as a “21st century trade agreement, replete with twenty-nine different chapters covering everything from tariffs to environmental quality. Indeed, the TPP aims to tackle a litany of trade-relevant topics that have been left out of previous trade agreements. In particular, the TPP is likely to impose stringent restrictions on competition from state-owned enterprises, business-friendly protections on intellectual property, and strict rules on government procurement as well new issues, like e-commerce and cloud computing. If they succeed, the TPP negotiations will have set the agenda for free trade standards for many years to come and will allow the US to set a lasting impression on the face of global trade.

Currently the TPP involves 12 negotiating partners: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. If it succeeds, the TPP will encompass roughly forty percent of the global economy. Combined with a potential twin agreement between the US and Europe, the Transatlantic Trade and Investment Partnership (TTIP), the TPP poses to achieve much of what WTO negotiations failed to achieve during the Doha Round of negotiations (2001-2008).

| Table 1: TPP Negotiating Partners |

How likely is the TPP to be concluded? This, in large part, depends on the preferences of each individual member of the negotiations and what is being offered. As shown by Table 1, the members of the TPP-12 are quite diverse in both economic size and income level. Unfortunately, it is difficult to provide a complete assessment of what is being offered, as the negotiating documents and draft chapters remain classified. Nevertheless, some details have been leaked – enough to confirm that the TPP will indeed be a very stringent and comprehensive agreement. Some of the more controversial aspects of the TPP include strict IPR provisions that may make pharmaceuticals in poorer members much more expensive and deregulation that hinder countries’ efforts to maintain safety and environmental standards.
The TPP also includes language that will make it possible for companies and multinationals to sue governments if they believe their market access is being restricted. Potential applications of this might be by tobacco companies who disagree with government restrictions on cigarette advertising or oil companies who sue local authorities when they enact stricter environmental guidelines. The agreement also seeks to impose strict regulations on the role of state-owned enterprises, so that they do not enjoy unfair access to licenses, contracts, or state finance. This will be difficult to swallow for countries in which the state-owned sector accounts for significant portions of the economy, like Vietnam, Singapore, and Malaysia. In Vietnam, at least, the potential gains from accessing the US apparel market unfettered appear to have won over the authoritarian communist party, but the ramifications of dismantling their SOEs are very hard to imagine.

At a more general level, we can look at the basic features of the negotiations for clues as to their eventual outcome. At the heart of any supranational agreement is the tradeoff between the benefits of coordination and the loss of independent policymaking authority. Generally, it is believed that the size and scope of a union is inversely related to the degree of heterogeneity between the countries inside it. A union that involves too many activities will be favored by few and a union which focuses on a narrow set of core activities will be favored by many (Alesina, Angeloni, and Etro 2001). In other words, we should expect two types of unions: small ones that coordinate a lot, or large ones that coordinate very little. Applying this logic to the TPP suggests a clear source of tension; the TPP involves a large and diverse set of countries (including the world’s leading economies) but seeks to coordinate an unprecedented range of activities.

Why is the US sponsoring another uncertain free trade arrangement? The short answer is that the United States has always been a force for FTAs. Beginning in the 1980s, following failed GATT negotiations in 1982, the United States brokered its first post-war bilateral trade agreements with Israel in 1985 and Canada in 1989 (Panagariya 1999). In the early 1990s, some believe that President Clinton’s push on NAFTA and upgrading of talks with APEC put pressure on the European economies to come to an agreement on the Uruguay Round of WTO talks (Haggard 1997; Bergsten 1994). With the conclusion of the Uruguay round in 1994, US interest in RTAs appeared to have subsided. Yet, recent deadlock at Doha has once again prompted the US to seek out regional strategies with willing partners, the most prominent of which is the TPP.

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10 (Pilling and Donnan 2013)
11 The US is also pursuing a parallel free trade agreement with Europe, the Transatlantic Trade and Investment Partnership or TTIP. Although TTIP covers a larger share of global trade than the TTP, due to relatively low preexisting tariff rates between the US and Europe, the agreement’s potential impact is actually smaller than that of the TPPs.
The TPP, however, represents more than just another RTA for the United States. As described by members of the Obama administration, including President Obama himself, the TPP is central to the American “rebalance” towards Asia.\textsuperscript{12} Integration may also lead to non-trade spillovers and a need for policy coordination among members, further cementing their co-dependence and common interests. For example, regional trade agreements, like Mercosur and NAFTA, have encouraged cooperation on a wide range of legal and institutional dimensions. The hope is that something similar will occur in Asia Pacific, allowing the US to further cement its indispensable role in the region.

The high aspirations of the TPP have contributed to its protracted negotiations, but they also set the TPP apart from any previous arrangements. Unlike any existing agreements,\textsuperscript{13} the TPP integrates trade, investment, and dispute resolution into one common package. As a result, the TPP is commonly described as the “gold standard” of RTAs, one that satisfies the core remaining challenges to free trade in the region, including government procurement, intellectual property and competition from state-owned enterprises. The TPP also covers issues that did not exist during the Uruguay rounds, like e-commerce and cloud computing, as well as issues that are not directly related to trade, such as labor standards and environmental protection. As such, even if TPP negotiations lead to further concessions on free flows of goods, a high bar has been set and it is unlikely to come down too far.

Nevertheless, as a RTA, the TPP will never be as effective as a multilateral agreement because, even though it generates trade-liberalizing benefits for member economies, it risks diverting trade from those excluded from the RTA (Bhagwati and Panagariya 1996). In principle, therefore, the TPP goes against stated US objectives on multilateral free trade promotion. For practical reasons, however, the TPP makes a lot of sense as it allows those countries with the greatest interest in free trade to negotiate privately. At the same time, the rigor of the TPP may make it difficult for some of the negotiating partners - even the United States - to comply. For example, the TPP calls for expansion of union rights when less than eighteen percent of US industry is unionized. Getting a diverse set of countries, including communist Vietnam and a cautious Japan, to all agree on the TPP provisions will be very difficult. Already, Japan has lobbied for and received concessions on its “five sacred products”, rice, barley and wheat, sugar, dairy, and beef and pork.\textsuperscript{14} As the negotiations enter their twentieth round, further watering down is expected.

The compromises the US may have to make if the TPP is adopted are modest in respect to the gains it stands to make by prying open the pacific economies. Negotiations between big and small

\textsuperscript{12} Previously, the “rebalance” towards Asia was referred to as the Asia “pivot,” a term that has been largely discontinued due to its somewhat confrontational connotation.

\textsuperscript{13} See (Panagariya 1999) on the differences between PTAs, FTAs and RTAs.

\textsuperscript{14} http://ajw.asahi.com/article/business/AJ201311170024.
economies tend to produce a ‘law of the jungle’ effect, whereby the interests of the big economy overshadow the smaller ones. In the case of the TPP this means that the eleven negotiating partners are at a disadvantage vis-à-vis the US unless they are able to coordinate a collective effort. Coordination, however, is unlikely as the negotiating partners compete on multiple dimensions and their only obvious common denominator is the mutual interest in improving their terms of trade with the US, their largest export destination. Moreover, even though the current TPP negotiators include some very large economies (Japan and the US), the bulk are relatively small, at least with respect to US economy, and are therefore more dependent on agreements like the TPP to coordinate and preserve open markets (Kowalczyk 2000; Alesina, Spolaore, and Wacziarg 2000). For these same reasons, it is the small economies that face the most significant welfare losses if they do not join regional trading blocs (Krugman 1991; Kose and Riezman 1997).

The big-small dynamic is one reason why the potential involvement of China is such a big wild card. At a conceptual level, China’s entry into negotiations should dilute the influence of the United States. Picture a whale in a pool with small fish – the odds are clearly stacked. Add in another whale, however, and suddenly the smaller fish have more space, as the two whales get in each other’s way, and previously burdensome features seem attractive. US insistence on rules on government procurement and state-owned enterprises may seem onerous for Vietnam,15 but if they also apply to Vietnamese trade with China – they become much more attractive. China’s entry is also likely to pressure the US to make concessions on strict IPR and exchange rate provisions, both of which put developing economies at a disadvantage. Most importantly, adding China into the mix gives the smaller economies a great new ecosystem to feast on. Today, China is a core importer for practically all the TPP member states. As incomes in China continue to rise and as the economy becomes more sophisticated, demand for imports will rise, as will the prospects of Chinese outward investment in the region. An agreement that includes China also provides some insurance the China will remain open to free trade into the future, when its imports from the region begin to overtake its exports.16

As attractive as China’s expanding economy may be for its regional neighbors, China’s recent assertiveness over long-standing territorial disputes has led some to revaluate their positions towards China and the United States. In May 2014, for example, China parked an oil drilling station in disputed waters, south of Hainan and East of Vietnam’s Danang province. The move prompted protests from Vietnamese officials at the UN and Vietnamese citizens in the streets who vented their anger on Chinese businesses (though many turned out to actually be Taiwanese). Vietnam is not the only country in the

15 Vinatex, a government SOE, reportedly accounts for 40% of apparel production and 60% of textile production in Vietnam.
16 See (Panagariya 1999)
region concerned about a rising China. In September of 2013, China began maneuvering its navy around the Scarborough Shoal, in an effort to prevent Philippines supply vessels from reaching the Thomas Shoal, a key outpost in the Philippines’ claim to sovereignty over the island chain. Similarly, authorities in Myanmar have grown wary of China’s influence in the northern part of the country, bordering China’s Yunnan province, where the economy, administration, and even the time of day is synchronized with Beijing than with Naypyidaw. It is not surprising, then, that much of the region sees closer ties with the Unites States as a bulwark against China. In 2009, for example, president Myanmar’s president Thein Sien announced Myanmar’s interest in improving political relations with the United States. Barack Obama reciprocated by becoming the first sitting US president to visit the country in 2012. Similarly, China’s oil rig prompted a series of warm embraces between a nervous Vietnam and an eager United States (Dien 2013) and new defense agreement with the Philippines.

Regional enthusiasm for the TPP can be attributed, at least in part, to a similar logic, i.e., entering into a preferential trade agreement with the United States helps balance the impending weight of China’s economic rise. Yet, it is nearsighted to think that China’s neighbors will simply balance away from China and ignore the market opportunities described earlier. China is an extremely important economic player in the region. Although Japan still dominates intraregional trade, China’s shares are growing fast. China is the largest regional importer of parts and components and a major importer of commodities. China is also deeply enmeshed in regional production-sharing arrangements and, although the majority of this trade has been with East Asia, China’s trade with ASEAN has soared over the last two decades. Currently, China absorbs roughly twelve percent of ASEAN exports. More importantly, China is emerging as an important source of FDI to the region, surpassing the US as the regions second largest investor after Japan (see Table 2).17

Table 2: FDI to ASEAN

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI to ASEAN</th>
</tr>
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<tbody>
<tr>
<td>2010</td>
<td>$50 billion</td>
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<tr>
<td>2011</td>
<td>$60 billion</td>
</tr>
<tr>
<td>2012</td>
<td>$70 billion</td>
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As China restructures its economy away from export-driven manufacturing and toward more high-tech industries and domestic consumption, the value of good relations with China will only increase. China’s leaders know this and they are unlikely to be perturbed by the recent warming of ties between its neighbors and the U.S. As China’s Foreign Minister, Qin Gang, said last April, “China is right here whether [the US] comes or not.”18 As such, the current economic environment surrounding TPP negotiations offers plenty of reasons why the TPP negotiators want China in the mix; they do not explain why China itself would want to join. This is not to say that there are not reasons for China to want to

17 (“Foreign Direct Investment in ASEAN – Key Findings” 2014)
join. This thought in mind, we proceed, in the next three sections, to assess specific arguments suggesting that China is likely to join TPP negotiations, namely, economic opportunity, international signaling, and domestic politics. We will argue that none of these arguments is particularly robust.

II: China’s Economic Stake in the TPP

The TPP poses to be the most substantial free trade agreement (FTA) of the 21st century, encompassing items that have largely been excluded from previous agreements, namely, non-tariff barriers, investment standards, and intellectual property. Since negotiations first launched in 2002\(^\text{19}\), the TPP’s formal negotiating partners have expanded from 3 to 12 nations. If concluded, the estimated size of the TPP trading block could amount to nearly forty percent of global trade and produce gains estimated at about US$295 billion for members of the pact (Petri, Plummer, and Zhai 2014). Successful negotiations, however, are far from assured. One of the main uncertainties concerns the role of China.

Many, both inside and outside the country, believe the agreement was deliberately intended to contain China. Entrance into the TPP, however, is based on voluntary accession not a closed list and the United States has repeatedly stressed that the TPP negotiations would never exclude China, should it choose to join them. Although such statements fall a bit short of a warm-hearted invitation, there are indications that China’s interest in the TPP has grown. In particular, shortly following Japan’s decision to enter talks in April 2013, China indicated that it too was evaluating the possibility of joining the TPP.\(^\text{20}\)

Whether China will actually join is still very unclear, but there are several compelling arguments for why it should. The most prominent of these is the economic argument, which simply asserts that China stands to lose out on potential trade benefits and trade volume if it does not join. In particular, given China’s role as the dominant exporter in the region, it has an incentive to join any agreement that could potentially expand its trade and investment flows or that prevents it from losing volume as a result of trade diversion. But how large are the potential trade-related benefits? Similarly, how large are the potential trade diversion losses to not joining? Answering these questions is essential for gauging the strength of the economic argument.

19 At the time, negotiations centered on the “Pacific Three Closer Economic Partnership” or TCEP framework, which evolved into the current TPP formation in 2011.

Estimating the Gains and Losses of Joining for China

Much of the gain from an FTA comes from trade creation, as originally identified by Viner (1950). Trade creation occurs when a member of the FTA begins to import from an FTA partner a good that it previously produced for itself. Since it would do so only if the partner produces it more cheaply than it can itself, both it and the partner benefit from this exchange in terms of the cost of the country’s total consumption (Deardorff 2013). Offsetting the gains to FTA members from trade creation are losses from trade diversion. Trade diversion occurs when a member country imports from a partner a good that it previously imported from a third (non-member) country. Because both countries previously faced the same tariff, we can assume that imports from the third country were due to lower cost. Sourcing from the partner country rather than the third country, therefore, means purchasing a higher cost good. As Deardorff (2013) notes, this loss to the importing country is not obvious to consumers, who find the higher cost product cheaper due to the absence of tariff. The absence of the tariff instead accrues as lost tariff revenue for the state. Bhagwati and Panagariya (1999) define trade creation and diversion succinctly in what they term the original Vinerian sense: a shift from an inefficient to an efficient source under trade creation and a shift from an efficient to an inefficient source under trade diversion.

Petri, Plummer, and Zhai (2012, 2014) use a computable general equilibrium (CGE) framework to gauge the magnitude of possible welfare gains from conclusion of a TPP agreement. The model they use is novel, specially developed by Zhai (2008) to incorporate firm-level differences in productivity, detailing 24 regions and 18 sectors and modified for the specific trade agreements in the Asia-Pacific.

Without China, countries joining the TPP will benefit through the creation of trade among its members, enhancing average productivity, expanding consumer variety, and increasing price competition. For the TPP-12, Petri, Plummer, and Zhai (2014) estimate total income gains of US$223 billion (in 2007 dollars) by 2015. Given the relative size of their economies, about four-fifths of the gains are predicted to accrue to the United States and Japan. The US has FTAs with half the expected TPP members, but not with Japan. The largest effect of the TPP-12 will be through the US-Japan relationship, with Japan’s gain estimated to exceed those accruing to the US. The estimated gains for Malaysia and Vietnam exceed those for Singapore and Mexico, a combination of geography and comparative advantage, despite the almost similar shares of manufactures in each country’s total merchandise trade (see Table 3).

Table 3: Manufactures as Share of Merchandise Trade

Non-member countries are not affected at all by trade creation, at least not directly. However, as a non-member of the TPP-12, China may lose as a result of trade diversion. As Deardorff (2013) notes, “One does not need subtle theoretical analysis to realize that outside countries are harmed by an FTA, to
the extent that the markets for their exports are reduced. This effect of an FTA is arguably more important than any loss to partner countries, since it is both inevitable and potentially large.” Petri, Plummer, and Zhai (2014) estimate welfare losses on the magnitude of US$34 billion by 2025 for China under TPP-12 alone. These losses are large relative to the total gains to the members: an estimated 15% of total gains are offset by trade diversion costs estimated for China. Yet, these losses are small when viewed in the context of China’s economy: by 2025 they are only an estimated 0.2% of China’s baseline GDP of US$17.2 trillion.²¹ Petri, Plummer, and Zhai also estimate net losses for Hong Kong, Indonesia, Thailand, and the Philippines.

One explanation for the small size of potential losses to China of not joining the TPP initially is that it already has preferential agreements with some of the TPP-12 countries. China has FTAs with the AFTA (Malaysia, Singapore, Brunei, and Vietnam) countries as well as with Chile, New Zealand, and Peru. Nearly all exports and imports to those members are already subject to zero tariffs, so that no tariff-related trade diversion will occur.

But this leaves Australia, Canada, Japan, Mexico, and the United States as TPP members with whom China has no FTA and where it can expect a decline of exports due to trade diversion. By 2007, the United States was the most important individual-country market for Chinese exports and Japan the third largest (Dean, Lovely, and Mora 2009). These important bilateral flows suggest that China would experience major losses from trade diversion as a non-member of the TPP. However, as shown in Figure 1, average MFN tariffs in all TPP countries on merchandise trade are already low and this partly accounts for the small estimated losses to China through trade diversion. Nevertheless, the small magnitude of the trade diversion estimated by Petri, Plummer, and Zhai (2014) is surprising given that the TPP reduces barriers on trade in agriculture and services, two areas where China still faces significant barriers.

Figure 1: MFN Tariff Rates of TPP Negotiating Parties and China

Although many aspects of the complex TPP agreement have not been fully defined, Petri, Plummer, and Zhai (2014) use their model to estimate the additional gains accruing from the expansion of the TPP-12 to a TPP-17 by the inclusion of China, Indonesia, Korea, the Philippines, and Thailand. Global benefits would rise enormously by the inclusion of these four members, expanding from US$223 billion to US$1908 billion by 2015. Over half of the additional gains would accrue to China, with the estimated welfare effect changing from a US$ 35 billion loss for TPP-12 to a gain of US$ 808 billion by 2015. Remarkably, over 40% of the estimated global gain is expected to accrue to China alone. But the

²¹ Estimates drawn from Petri, Plummer, and Zhai (2014), Table 1, and expressed in 2007 US dollars.
TPP-12 partners would also experience larger gains through the inclusion of these five Asian economies in the FTA, as predicted benefits triple, from $285 billion to $893 billion by 2025.\textsuperscript{22}

\textit{The Possibility of Foreign Direct Investment Diversion}

The inclusion of investment provisions is not new to the TPP. Beginning with the North American Free Trade Agreement and then into the TRIMs provisions of the Uruguay Round of the GATT, trade agreements have explicitly acknowledged the link between multinational investment and trade flows. Foreign investment is a priority for the United States in its negotiations, especially the right of establishment by foreign goods and service providers in the partner-country territory. Although the details have yet to emerge, issues under discussion include non-discriminatory treatment of foreign investments and investors; minimum standard of treatment; rules on expropriation; transfer of payments of the foreign investor out of the host territory; state-to-state and investor-state dispute settlement procedures; and prohibition on performance requirements such as mandatory export levels and local content stipulations (Fergusson et al. 2013, p.40).

Beginning in initial openings through Special Export Zones in 1979, foreign direct investment (FDI) has played an important role in China’s development. It remains important today, as a conduit for foreign technology and as the base for deep linkages into global supply chains. As shown in Figure 2, net foreign direct investment inflows to China have grown rapidly since China’s entry into the World Trade Organization in 2001. Remarkably, net FDI inflows to China have exceeded those into the United States since 2009. While the largest share of foreign capital comes from Hong Kong and other ethnically Chinese economies, Japan and the United States have been the most important investors from the developed economies.

\begin{figure}[h]
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\includegraphics[width=\textwidth]{figure2.png}
\caption{Foreign Investment Inflows to China}
\end{figure}

It is difficult to overstate the importance of production fragmentation and foreign-invested enterprises (FIEs) to Chinese trade flows. Processing trade, the import of intermediates for assembly and transformation in China and their subsequent re-exporting, lies behind much of the growth in China’s imports and exports.\textsuperscript{23} Although China’s reliance on processing trade has fallen over time, in 2007 half of its total exports were processing exports.\textsuperscript{24} Production fragmentation and regional specialization is especially important in China’s trade with the United States and Japan. In 2007, 62.5\% of China’s

\textsuperscript{22} ibid.
\textsuperscript{23} See Hammer (2006).
\textsuperscript{24} Statistics on processing trade shares in this paragraph are drawn from Dean, Lovely, and Mora (2009).
exports to the United States and 56.6% of its exports to Japan were processing exports. Much of these processing exports were mediated through FIEs. From 1998 to 2007, American foreign direct investment in China averaged $3.9 billion per year, while Japanese foreign direct investment averaged somewhat more, $4.3 billion per year. In 2007, 86.2% of China’s total processing exports to the US came from FIEs, with a very similar share (86.9%) of total processing exports to Japan coming from FIEs.

In some respects, the investment and intellectual property provisions of the TPP are more important than its promised reduction in tariffs. From this perspective, investment related provisions of the TPP have the potential to further expand and deepen the production fragmentation, regional specialization, and wealth creation unleashed by the IT revolution and the liberalization of trade and investment policies in the developing world. Further support for the view that the TPP is important to China’s continual receipt of foreign direct investment comes from studies of the determinants of FDI flows. Among other studies, Büthe and Milner (2008) analyze FDI flows into 122 developing countries over the period 1970 to 2000 and conclude that joining international trade agreements allows developing countries to attract more investment and, thus, to increase economic growth. They argue that international commitments regarding the treatment of foreign investors are more credible than domestic policy choices because they raise the cost of backsliding.

If China fails to join TPP, it may see FDI diverted away from its shores toward middle and low-income countries that are TPP members. Already, there has been substantial movement of foreign investment in labor-intensive industries such as footwear, apparel, and sporting goods away from coastal China. The main driver of this movement of footloose industries is believed to be the steady increase in Chinese real wages, which have grown an average of 10 percent per year over the past decade. The greater investor protections and enhanced dispute resolution procedures offered by the TPP may simply amplify this ongoing trend by making alternative locations even more attractive.

While some sectors have migrated away from China, a second look at Figure 2 suggests that this investment diversion cannot be large relative to the total inflow. First, the size of foreign investment flows into China dwarfs flows into any middle or low-income country in the TPP-12. Secondly, the size of these alternative economies is small relative to the size of potentially deflected investment flows. As shown earlier in Table 1, only Mexico has a gross domestic product that exceeded US$1 trillion in 2012, in comparison to FDI inflows to China in the same year of almost US$ 300 billion. Moreover, Mexico is an unlikely alternative for production that will receive further processing in East Asia since it is not within the region. Finally, Mexico’s manufacturing wages exceed those of China.

In addition to investor protections, through the TPP the United States seeks intellectual property rights (IPR) protections that “reflect a standard of protection similar to that found in U.S. law” and which exceed those provided for in the WTO Trade Related Aspects of Intellectual Property (TRIPS) Agreement.
Because such “TRIPS plus” provisions are seen as investor friendly, there is again concern that a failure by China to join the TPP negotiations will diminish its attraction as a location for export-processing investment.

Such concerns may be overstated, however, when we consider two features of the current investment landscape. First, since joining the WTO, FDI inflows to China have soared, as discussed above. This trend suggests that the TRIPS provisions provide a level of protection that has increased investor confidence substantially. Secondly, a comparison of China’s existing level of IPR to those in place in other TPP-12 countries suggests that China is hardly an outlier in this regard. The well-known Park index of patent protection is provided for the TPP-12 countries plus China in Table 4. By 2005, China’s score of 4.08 on the Park index exceeds all other middle and low-income TPP countries as well as that given to New Zealand. Through this lens, China is making significant progress on patent protection without the “hard law” provisions of the TPP.

**Table 4: Intellectual Property Rights Index**

A final, and important, reason to argue against significant FDI diversion if China fails to join the TPP is the impending Bilateral Investment Treaty (BIT) between China and the United States. BIT talks began in 2008 and have recently achieved rapid progress, with reports that the parties have concluded the basic agreement and are moving forward with creation of “negative lists,” which detail sectors closed to foreign investors. In 2013, the two countries agreed to BIT talks on the basis of pre-establishment national treatment (PENT) with a negative list approach. PENT means that foreign investors will be accorded national treatment in the pre-establishment phase of their businesses. Such an arrangement represents a major departure from the current Chinese national investment approval system and it creates an environment for foreign investors that provides many of the disciplines sought through the TPP.

While the TPP contains other provisions that go beyond existing and proposed agreements to which China is party, evidence suggests that China’s economic losses from not joining the TPP are unlikely to be other than negligible. Current barriers to trade between the TPP-12 and China are already low and trade flows are already enormous. China receives the lion’s share of foreign direct investment into the developing world, reflecting in part substantial progress already made in the policy environment facing foreign investors. Lastly, China has other mechanisms, such as the Bilateral Investment Treaty, that provide selected liberalization in Sino trade and investment regimes.

\[25\] (Park 2008)
Section III: International Diplomacy

Another commonly proposed argument for why China is likely to join the TPP is that it needs to signal its commitment to free trade and its desire to become a more sophisticated economic player. Joining the TPP would certainly contribute to each of these objectives. But the TPP is not the only avenue China has for making these signals. Since the mid 1990s China has entertained the possibility of a Free Trade Agreement with the Asia Pacific (FTAAP), which includes many of the current TPP negotiation constituents. In 2004, China concluded the China ASEAN Free Trade Agreement (CAFTA) and is poised to adopt a much larger and more significant Regional Comprehensive Economic Partnership (RCEP) with the ASEAN states in 2015. Underneath these regional arrangements lies a tangle of Chinese bilateral trade agreements (BTAs), which offer China various avenues through which to maintain existing trade relations.27

The TPP is, by far, a ‘higher quality’ agreement than anything China already has in place, so should not be compared with the existing arrangements. However, it is not at all clear whether China is interested in, or even capable of subscribing to all these high standards. Indeed, China has criticized the "one size fits all" approach to the TPP negotiations, by pointing out that there are developed as well as developing countries at the negotiation table and that it is unreasonable to expect that they all agree on the same issues. Moreover, China has been busy marketing alternative arrangements that appeal to developing economies in the region. While China’s efforts are unlikely to derail the TPP negotiations, their entreaties are resonating with some ASEAN members. During the inaugural 2013 US-ASEAN summit, Malaysian Prime Minister Najib Razak stated that a more flexible approach was needed in future trade negotiations, as ASEAN members were not simply "yes men."28 In a rare case of common opinion, Anwar Ibrahim, the Malaysian opposition leader, has also come out in criticism of the TPP as an attempt by the US “to impose its brand of economic model” on unwilling countries. In Japan as well, the country’s chief TPP negotiator has subtly pointed out that the TPP provides a blank check on monetary policy but imposes strict restrictions on exchange rate policy, terms that seem to benefit the United States at the expense of exporters.29

China’s push for TPP alternatives, or is it likes to refer to them: “complements,” has a simple sales pitch, namely, TPP-like trade coordination without the TPP-level of stringency. China hopes to advance a “win-win” approach to integration that focuses on investment in infrastructure rather than rigid

27 As of early 2012, China has signed BTAs with ten countries/regions: Hong Kong, Macau, Taiwan, Pakistan, Chile, New Zealand, Singapore, Peru and Costa Rica, and is negotiating with Australia, Iceland, South Korea, Norway, Switzerland, as well as the Gulf Cooperation Council (GCC), and the Southern African Customs Union (SACU).
28 http://ajw.asahi.com/article/asia/china/AJ201310100071
29 (Obe 2014)
institutionalization. China has even appealed to the noodle bowl analogy by arguing that there are too many FTAs and BTAs in the region (even though a large portion of them involve China) and that a new mega-FTA would actually simplify matters. As contradictory as these claims may seem, it is helpful to approach the Chinese alternatives for what they are: more attractive versions of the TPP.

What exactly is China putting its weight behind? First, China is actively promoting the Regional Comprehensive Economic Partnership (RCEP) for East Asia, which would include the ten ASEAN members, Australia, India, Japan, Korea, New Zealand, and of course China. Unlike the TPP, RCEP is very much a regionally motivated idea, not a meeting of like-minded economies. RCEP regional character represents both its strength and its weakness. China, for instance, likes to stress the point that RCEP is grounded in ASEAN centrality and that “close neighbors are better than distant relatives.” This message is likely to resonate with those in Southeast Asia who are dissatisfied with the selective annexation of ASEAN economies into the TPP. RCEP’s regional mandate also gives it the flexibility of incorporating India, which has also been left out of the TPP negotiations. The regional motive, however, also makes RCEP a less feasible configuration due to the diverse set of interests it needs to accommodate. To put it in slightly different words, RCEP is attractive for the region but it is unlikely to get off the ground any time soon, even if China is leaning on it. Yet, if China is simply interested in using RCEP to slow down TPP negotiations, attractiveness trumps urgency.

On this count, RCEP has several enticing features. For example, China has raised the prospect of flexible rules of origin (ROOs) for RCEP, which would allow products to circulate seamlessly across countries during their production cycle. RCEP would also allow members to ease into liberalization by allowing for sector-specific reductions. For example, RCEP members could focus initial efforts on sectors, such as tourism and textiles, which are relatively easy to expose and tend to generate quick returns. Such provisions, even if they are unlikely to materialize any time soon, complicate the TPP process, which promises to adopt strict ROOs and blanket tariff reductions, though recent concessions to Japan suggest that the blanket may have some holes in it.

In addition to RCEP, China is also trying to speed up negotiations regarding the Free Trade Area of the Asia-Pacific (FTAAP), which poses to be the largest RTA in history, both in terms of geographic and economic size. Under the “Yokohama Vision,” articulated during the 2010 APEC summit, FTAAP would be a natural progression from TPP and RCEP that would encompass all the APEC member countries, accounting for about 60% of the global economy. This is by far the broadest and least feasible of the three arrangements. Indeed, FTAAP, as a concept, has been around since the early 90s, with little

30 http://fta.mofcom.gov.cn/enarticle/enrelease/201405/15661_1.html
tangible progress made since. Until recently, negotiations were not even supposed to begin until 2020, but again China has upped the ante by announcing its intentions to push forward with FTAAP (Lee 2014).

Finally, it is important to note that although these alternative arrangements are more flexible and less stringent than what is being offered under the TPP, it does not mean that China will not improve its intellectual or physical investment environment. As mentioned, earlier, China is in the final stages of a US-CHINA Bilateral Investment Treaty (BIT), which will greatly improve the investment conditions of foreign firms operating in China, first by opening up previously opaque investment sectors and by offering much stronger intellectual property rights for firms operating in China. This is all in China’s interest as it tries to upgrade its industrial profile and move up the technological production ladder. As the United States is a core source of high tech investment in China, the US-CHINA BIT will go a long way in achieving these goals. Equally, importantly, the US-CHINA BIT will make it easier for Chinese firms to enter US markets without facing the uncertain pressures of US domestic pressures that they so poorly understand. China is also improving its physical investing environment, enacting labor and environmental standards that even US and European business groups describe as too stringent. The Labor Contract Law, adopted in 2007 and revised in 2012, for example, greatly strengthens the collective bargaining rights of Chinese workers and makes it harder for businesses to exploit inconsistencies in wage requirements. Similarly, the recently adopted amendment to China’s Environmental Protection Law, makes it much harder for polluting firms to get operating licenses and includes stiffer penalties that accrue daily for any uncorrected environmental violations. Already, US business authorities are noting that Chinese authorities are turning away polluting investors.

IV: Domestic Politics and the TPP

One of the great ironies of the TPP negotiations is that the United States, despite serving as lead architect and advocate for the agreement, may have trouble ratifying once it is concluded. The White

House is clearly behind the initiative (President Obama has highlighted the TPP as a core objective for his second term). But the TPP is likely to encounter obstacles in the House of Representatives, where Tea Party members appear bent on obstruction, as well as in the Senate, where democrats are weary of competition from cheap manufacturers in East and Southeast Asia. China’s entrance into the TPP trade talks would only complicate this process further. Both houses of congress have a long-standing ‘anti-China’ record, and many believe that China got an easy pass when it joined the WTO in 2001.  

*Domestic Constraints in the PRC*

Whereas America’s domestic political challenges for the TPP are well known and frequently discussed, China’s domestic political constraints have not been adequately addressed. This is not surprising. A single-party leadership—unimpeded by a formal opposition or the prospects of upcoming elections—is in charge in China, meaning that its ability to form and ratify international agreements is much less constrained than that of any of its more democratic negotiating partners (Putnam 1988). However, China’s CCP leadership is not a monolithic force. The country is highly fragmented, both administratively and geographically (Lampton and Lieberthal 1986; Montinola, Qian, and Weingast 1995; Xu 2009), as well as along factional lines (Nathan 1973; Shih 2004; Cai and Treisman 2006). Increasingly, scholars are also including the role of Chinese State-Owned Enterprises (SOEs) as a major interest group in Chinese domestic politics (Minxin 2006; Steinfeld 2000).

When it comes to free trade, these forces have rarely been in alignment. SOEs and the local governments that depend on them, for instance, have a lot to lose and little to gain from further liberalization, either in trade or investment. As a consequence, we can expect SOEs to resist any comprehensive RTA, especially the TPP, which carries specific provisions aimed at countering unfair competition from SOEs. Interestingly, however, the current administration has made SOE reform a top priority. During the Chinese Communist Party’s 3rd Plenum, held in November 2013, Xi Jinping made it clear that he envisions market forces to play a leading role in the future of China’s economy, read: SOEs will play a smaller role. Whether the administration will be successful in this effort is far from clear.

China’s domestic political constraints are unlikely to manifest in the same way as those of the United States. That is to say, provincial delegates are unlikely to challenge a TPP initiative in the National People’s Congresses (NPC), China’s preeminent legislative institution; nor are SOE lobbies likely to organize demonstrations against the elimination of protections that ensure them valuable profits. The pressure of domestic politics in China works its way behind the scene, making it extremely difficult to predict how local politics or special interests will influence China’s entry into the TPP. What can be

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36 [http://www.ft.com/intl/cms/s/0/08cf74f6-c216-11e2-8992-00144feab7de.html#axzz2U9X6IJK](http://www.ft.com/intl/cms/s/0/08cf74f6-c216-11e2-8992-00144feab7de.html#axzz2U9X6IJK)
said, however, is that these forces have prevented China’s leaders from implementing much needed reforms in the past (Minxin 2006). For example, the Hu-Wen administration (2002-2012) was expected by many to be the most reform-minded administration in the PRC’s history. By the end of 2012, however, most anticipated reforms, such as SOE liberalization and bank reform, had made zero, perhaps even negative, progress—leading many China scholars to bill the Hu-Wen period a “Lost Decade” for reform.\footnote{Johnson 2014}

The current Xi-Li administration appears considerably more assertive and consolidated than its predecessor, suggesting that, if the leadership wanted TPP, it might stand a better chance of forcing it onto sub-national administration and even on the SOEs. Many even argue that joining the TPP would help the regime achieve its reform objectives. They base these claims on a literature that shows how joining trade agreements can create pressure for domestic reform. For example (Burfisher, Robinson, and Thierfelder 2000; Whalley 1998) show that joining NAFTA put pressure on Mexican officials to remove agricultural protections in order to take full advantage of the trade agreement. The argument is not foreign to the Chinese case either. Zhu Rongji, for instance, is believed to have leveraged WTO accession to push through (Zweig 2001) and lock-in (Fewsmith 2001) economic reforms in the late 1990s and early 2000s. Similarly, Japan’s Shinzo, has billed the TPP as a “third arrow” in his quiver of reform for the Japanese economy (one and two being monetary and fiscal policy). Could the TPP serve a similar purpose under Xi Jinping and Li Keqiang? This is a compelling thesis, but it is not one that is supported by the regime’s current approach to reform.

Rather than calling for broad reaching reforms, as Zhu did in 1998, the current administration has proposed a more nuanced approach towards easing SOE’s out of the production economy, not just by selling them off, but by reorienting their interests towards investment (Kroebner 2013). In particular, as outlined in the sixty-point addendum to the Third Plenum Communiqué, the leadership wants SOEs to reorient assets away from manufacturing and distribution and towards investing in private businesses operating within their sectors.\footnote{“The Decision on Major Issues Concerning Comprehensively Deepening Reforms” 2013} This politically tactful approach allows the SOEs to preserve much of their wealth and to further cultivate their sectoral patronage networks while also discouraging them from production, where they have proven to be increasingly inefficient (Song, Storesletten, and Zilibotti 2011). Whether large SOEs will buy into this strategy and whether or not it will lead to improvements in private sector productivity is still unknown. What is clear, however, is that this approach would be undermined by a TPP-style trade agreement, which would require China to expose sectors to unfettered foreign investment, thereby undercutting the appeal of the reorientation strategy for SOEs. Given that many of China’s large SOEs operate in politically sensitive industries, like telecom, media, finance, and energy, it

\[\text{(Johnson 2014)}\]

\[\text{ (“The Decision on Major Issues Concerning Comprehensively Deepening Reforms” 2013)}\]
is unlikely the regime will give up protections on these sectors anytime soon nor is it likely to forfeit the power to channel investment and patronage within these lucrative sectors.

The desire to move incrementally and selectively is even more visible in China’s approach to internal Free Trade Zones (FTZs). In September 2013 China established its first FTZ in Shanghai, a 29 square kilometer stretch of land on the outskirts of Shanghai’s financial Pudong district. The Shanghai FTZ provides three functions. First, it removes tariff barriers to imports. Second, it expands the number of sectors open to foreign investment. Third, it encourages policy and legal innovation within the zone. These features would be welcome in most of China, yet there is no intention of scaling the policy nationwide. Instead, twelve additional FTZs are anticipated across a number of provinces, including Zhejiang, Shandong, Liaoning, Henan, Fujian, Sichuan, Guangxi and Yunnan, and cities such as Suzhou, Wuxi, Hefei, Guangzhou and Tianjin, but the process has been slow and opaque.39 One interpretation of the piecemeal FTZ approach is that it is a gradualist attempt at opening up China’s economy. An alternative interpretation is that liberalization is part of a broader and more complicated reform strategy, in which FTZs are selectively rewarded to important sub-national political actors in exchange for support on other reform dimensions. If this were indeed the case, the leadership would, as in the case of SOE reforms, lose a valuable political resource if it were to agree to blanket TPP standards on trade and investment.

To help understand why the TPP conflicts with China’s current reform strategy, it is helpful to look back at the Deng Xiao Ping’s approach to reform during the 1980s. At the time, Deng faced an entrenched bureaucracy that survived on the planning model, resistant to any attempt at reforming it. Deng, could have, if he had wanted to, taken the bureaucracy head-on. Instead, he chose to encircle it through what Susan Shirk calls, “particularistic contracting” (Shirk 1993, 15). This involved cutting deals with particular parts of the bureaucracy in exchange for support on further reforms. In the case of price reform, for example, Deng offered dual-track pricing that allowed prices to rationalize while giving select portions of the bureaucracy access to below-market rates. While it was obvious this setup would incentivize corruption through arbitrage, it nevertheless allowed Deng to build and dismantle reform coalitions with limited resistance.

Deng’s particularistic contracting was even more pronounced in the designation of Special Economic Zones (SEZs) in Shenzhen, Tianjin, Dalian and Xiamen. As with price reforms, Deng selectively handed out SEZ status as a way of building support and preempting opposition to further reform (Crane 1990; Shirk 1993). Moreover, by focusing on these select locations, Deng was able to channel central resources to insure that the SEZs were exceptionally successful, so as to foster envy

http://news.xinhuanet.com/english/china/2014-01/22/c_133066293.htm, the government has retracted from this position a little, but most believe the information was valid, albeit premature.
among those who had not been selected (Shirk 1993). Had Deng chosen to open the economy in broad-brush stroke he would undoubtedly have faced stiffer opposition. More importantly, had he chosen to open the economy broadly, Deng would have many fewer beholden supporters on other aspects of his reform strategy.

The current Xi administration has made it clear that the end goal is liberalization. However, as was the case under Deng, arriving at that goal will involve a politically calculated, piecemeal strategy. The first move in this strategy, Xi’s inaugural tour of Shenzhen, was clearly symbolic. Deng essentially gave birth to Shenzhen’s economic miracle by making it China’s first SEZ. The second move, opening the Shanghai FTZ, was tactical. Shanghai has long been seen as the base of Jiang Zemin’s faction, long considered the informal opposition to the Hu administration and, more recently, an existential threat to Xi Jinping. Shanghai is also, to the surprise of many, one of the China’s SOE strongholds, with over 60 percent of output coming from some of China’s most prominent SOEs, like SAIC, China’s largest automobile manufacturer, and China Unicom, the country’s second largest telecoms provider. As such, choosing Shanghai for China’s first FTZ sends two messages, that Xi intends to retake the city and that SOEs will be targeted. A year into the FTZ, the strategy finally appears to be paying some dividends. Han Zheng, the current Shanghai Party Secretary and long-time associate of Jiang Zemin, appears to have shed his old patron and adopted a new one: a recent article, penned by Han, praises Xi in Shanghai’s Liberation Daily. Several of Shanghai’s prominent SOEs are also starting to tow the line by selling off stakes to private equity funds and the newest round of FTZs are poised to open in Hefei, Tianjin and Guangzhou. It is unlikely that the leadership will abandon this strategy by signing on to the TPP.

Another political strategy that might be compromised by a rigid TPP is China’s Western Development Initiative, sometimes referred to as the “Go West” policy, intended to accelerate the development and narrow the gap between the western and eastern provinces on income, investment, production, and education. Part of this policy involves building up infrastructure connecting China’s western hinterlands with the dynamic coastal cities in the East. The policy also entails various efforts at creating preferential investment opportunities for both domestic and foreign firms who invest in the West, including tax breaks, fast-track registration, and, unfortunately, weaker regulation. There are political and economic reasons for the CCP’s push towards the West. Politically, the western provinces, especially Xinjiang, Tibet, Gansu, and Sichuan, contain are some of the more restive regions in the country. While oppressive government policies are partly to blame, so is excessive poverty which is much more prevalent in the Western provinces. Economically, this is also an opportunity as wages in western China are still

40 (Han 2014)
41 (Inman, Deng, and Hong 2014)
42 for further background see: (Tian 2004; Ziran 2002)
low, about seventy percent of that in the east.\textsuperscript{43} Things were much worse, however, before the western development policy came into effect and policymakers can take some credit for that. For example, poverty in western China has fallen by more than half (over 30 million people) since 2000. State-led investment and policy incentives also appear to have been successful in attracting increasing amounts of foreign investment. Observing rates of change from 2005 through 2012, we see that western provinces had the fastest growth across China (see Figure 3). While it is unclear how this picture would have differed based on purely market-led investment, it is unlikely that China’s leaders are ready to give up these powerful policy levers when they appear to be bearing fruit.

\textbf{Figure 3: Provincial Foreign Investment Inflows}

Political strategy aside, China also has some unique economic reservations about the TPP. Unlike its potential TPP counterparts, who are primarily concerned with direct costs of foreign competition, such as on agriculture in Japan, China is concerned about the opportunity costs from foreign competition on sectors that have yet to emerge. China domestic consumption economy is growing rapidly and it is expected to grow even faster once the leadership implements reforms and property rights and household registration. Foreign investment will certainly play a role in this expansion. Indeed, Premier Li Keqiang has emphasized, on a number of occasions, the need for foreign investment in all types of industry. Yet, unfettered foreign investment today may preclude Chinese producers from competing in this emerging domestic market tomorrow. A clear example of this risk is visible in China’s automobile industry where foreign investment is restricted to joint ventures. Although foreign partnership is helping Chinese firms innovate, it is not making them more competitive as Chinese consumers still flock to the foreign branded version of domestically produced vehicles.\textsuperscript{44}

Similar concerns exist about China’s budding services sector. In the first quarter of 2014, for example, services accounted for over 60 percent of China’s GDP growth.\textsuperscript{45} Services are also employing an increasing share of the Chinese labor market. Indeed, in 2010, the services sector employment in China surpassed both primary and manufacturing (see Figure 4). Unfortunately, China’s service sector is less productive than the manufacturing sector and therefore more vulnerable to foreign competition (Nabar and Yan 2013). For example, financial services in China have long been seen as inefficient and in

\begin{itemize}
  \item \textsuperscript{43} See: “Western China: Enhancing Industrial Competitiveness and Employment” UNIDO Technical Report US/CPR/03/051. Available at: http://www.unido.org/fileadmin/user_media/Publications/Pub_free/Western_China_enhancing_industrial_competitiveness_and_employment.pdf
  \item \textsuperscript{44} (Young 2014)
  \item \textsuperscript{45} http://blogs.piie.com/china/?p=4058
\end{itemize}
need of reform. TPP standards would certainly go a long way in strengthening this sector, but it might mean an early loss in domestic market share that will be hard to make up.

**Figure 4: Chinese Employment By Sector**

As in most countries, economic interests in China at times overlap with political ones. Take for example China’s media market, which is the largest in the world. A genuine implementation of the TPP would require not only opening media to foreign investment, currently restricted to a limited range of advertising and distribution, but also curtailing censorship and editorial oversight, neither of which seem likely anytime soon. If anything, investment into Chinese media is getting harder, with only a handful of foreign content providers operating in the country. If Vietnam, which has had a bilateral trade and investment agreement with the United States since 2001, is any comparison, these politically sensitive sectors will remain heavily restricted well into the future (Malesky, Gueorguiev, and Jensen 2014).

**V: Summary and Predictions**

This paper assesses the prospects of China’s joining the current TPP negotiations, a move that would vastly alter and augment the impact of an agreement as well as the likelihood that it will be successfully concluded. In particular, Chinese involvement would likely both slow down and water down the current TPP negotiations but it would also expand the TPP’s economic girth to roughly fifty-five percent of global GDP and offer the current TPP negotiating partners a much more enticing reason to sign off on the agreement: preferential access to China’s budding domestic market. Without indulging in the merits of another regional trade agreement, on which opinions are hotly divided, we address the various existing arguments for why China is or is not likely to join. Having found many of the former and few of the latter, we provide our own responses to why a TPP with China in it is unlikely. Specifically, we address three arguments commonly raised as to why China is likely to join, namely, that it would be economically prudent for it do so, that it would be diplomatically prudent for it do so, and that it would be strategically prudent to do so with respect to China’s domestic political environment.

With respect to each of the argument outlined above, we concede that the claims are valid but not significant enough to be convincing. Moreover, we point out that these arguments miss important features of China’s approach to diplomacy and domestic politicking. In particular, we point out that although China does indeed stand to lose out from not joining in the TPP negotiations, its losses are predictable and negligible but its short-term costs are indeterminate and potentially quite large. With respect to diplomacy, we concede that China’s failure to join in TPP negotiations may undermine China’s reputation as a free marketer and put it in a weaker position should it choose to join the TPP after its finalized, but we also point out that China’s has alternative avenues through which to lay its stake on free
market politics and parallel levers from which to put pressure on the TPP negotiations, even if it is not in the negotiating room. Finally, while we agree that joining the TPP would serve as a powerful weapon in the current Chinese administrations fight against entrenched SOEs and obstinate bureaucrats, we cannot ignore the valuable patronage the administration would forfeit should it forgo its current piecemeal approach to reform and adopt the TPPs blanket provisions on trade and investment.

While we arrive at an unambiguous conclusion - China will not join the TPP negotiations - we should also point out that from our perspective, this is not a big deal. China is so deeply embedded in the global supply chain, and in particular with nearly all the TPP negotiating partners, that it will be indirectly included in the TPP whether or not it is a formal member. This does not mean that the TPP members will not lose out from not having China as a member. They will. Yet, even then these losses are unlikely to last for long. China is actively pursuing alternative arrangements with virtually all the TPP member states and as long as the TPP negotiations remain in motion, so will these parallel arrangements. The end-game outcomes of all this may in fact turn out to be a broader, albeit less stringent, free trade area that includes many important but currently excluded economies, like India, Indonesia, Thailand, and Russia. India, for one, has never before been invited to regional summits, but China has upped the ante so to speak by inviting the current Indian Prime Minister, Narendra Modi, to the APEC summit this coming November in Beijing and by making sure that India is party to the ongoing RCEP negotiations. This has added pressure on the US to extend its own overtures to the world’s third largest economy.

Involving India, just like involving China, compromises the US’s vision of a higher standards FTA. It also lowers the prospects of a successful TPP conclusion arriving any time soon. This is perhaps precisely the point. China’s dilemma is that the best case scenario for China is not a world without TPP, just a world where TPP makes a slower and softer landing, arriving ideally after the current leadership has consolidated its grip on power and around the same time it is able to cement a parallel agreement that cancels out America’s leading role in Asian free trade. This, of course, is not what the US is interested in and we can be sure that the Obama administration will press ahead in full force over the next year as it tries to reach a deal on TPP before the start of election season next summer. But as it presses ahead the US negotiators may want to pay more attention to how their Chinese counterparts are interpreting their moves and readapting their own. To this end at least, the US approach to TPP has been surprisingly effective in so far as it has managed to keep China positively engaged in the region and focused on winning over partners rather throwing its weight around. As John Ikenberry pointed out, “The United States cannot thwart China’s rise, but it can help ensure that China’s power is exercised within the rules and institutions that the United States and its partners have crafted.”

46 (Ikenberry 2014)
China is not party to the institutions, it is moving along a similar path as it tries to market its own parallel agreements.
Works Cited


Figures and Tables

Figure 1: MFN Tariff Rates of TPP Negotiating Parties and China.................................................................10
Figure 2: Foreign Investment Inflows to China..................................................................................................11
Figure 3: Provincial Foreign Investment Inflows .............................................................................................21
Figure 4: Chinese Employment By Sector ......................................................................................................22

Table 1: TPP Negotiating Partners ................................................................................................................3
Table 2: FDI to ASEAN ....................................................................................................................................7
Table 3: Manufactures as Share of Merchandise Trade ..................................................................................9
Table 4: Intellectual Property Rights Index .................................................................................................13
Figure 1: Average Simple MFN Tariff Rate on Merchandise Imports, by Year and Country


Figure 2: Foreign direct investment, net inflows (BoP, current US$ Billions), by Year and Country

Source: World Bank, World Development Indicators 2013
Figure 3:

Registered Foreign Investment
2005-2012

Exponential Growth %

- (7.28,11.79]
- (5.5,7.28]
- (4.98,5.5]
- (4.43,4.98]
- [-2.25,4.43]

Figure 4: Employment by Sector

(10000 Workers)
Table 1: Country Characteristics, TPP-12 Countries and China, 2012

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Source: World Bank, World Development Indicators 2013

Table 2: ASEAN FDI Inflows (Top Sources)

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(Millions US dollars)

Source: ASEAN Foreign Direct Investment Statistics Database
### Table 3: Manufactures as Share of Merchandise Trade, TPP-12 Countries and China, 2012

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Source: World Bank, World Development Indicators 2013

### Table 4: Park Index of Patent Rights, TPP-12 Countries and China, (Selected Years)

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