The Trans-Pacific Partnership: Perspectives from China

Dimitar D. Gueorguiev
Department of Political Science
Maxwell School of Citizenship and Public Affairs
Syracuse University
ddgueorg@maxwell.syr.edu

Mary E. Lovely
Department of Economics
Maxwell School of Citizenship and Public Affairs
Syracuse University
melovely@maxwell.syr.edu

November 13, 2015

Abstract: Once ratified, the American-led Trans-Pacific Partnership (TPP) will establish a free trade area spanning over forty percent of the global economy. Despite China's absence from the current architecture, speculations remain that the trading giant may still play a part in the bloc. We assess the possibility for a TPP-plus-China formation by addressing three common claims for why China is likely to join. The first is economic: China has the most to gain from tariff reductions and the most to lose from trade diversion. The second argument we evaluate is that China's absence will undermine its reputation as an open and peaceful partner. The final claim is that joining the TPP complements the current administration's declared reform objectives. Our assessment reveals that the economic losses to China from remaining outside the TPP are not large and that its reputation as a benevolent and reliable partner can be enhanced by support for alternative regional arrangements. Most importantly, we argue that the actual reform strategies employed by the current leadership would be severely compromised under TPP obligations. We conclude that China is unlikely to seek membership in the TPP, even as it seeks alternative routes to deeper regional integration.

Introduction

Heads turned in May 2013, when the White House formally extended invitations for China to join in negotiations over a proposed Trans-Pacific Partnership (TPP), a twenty-first century regional trade agreement poised to be the world's largest and most advanced.[1] Up until this point, the TPP was widely seen as an "anyone-but-China club," especially by the Chinese who saw it as a deliberate attempt to contain their economic rise.[2] To be sure, it did not help that prominent US officials went on record describing the TPP as a "centerpiece" in America's "pivot" towards Asia.[3] Unsurprisingly, many dismissed America's invitation as a hollow courtesy—extended precisely because China would not and could not accept. Yet, when, on May 30, 2013, China's Ministry of Commerce (MOC) announced that it would, "analyze the pros and cons of joining the Trans-Pacific Partnership (TPP)," the idea of a TPP that included China suddenly transformed from a pie in the sky to a real and very tantalizing prospect.[4]

The year following America's invitation inspired hopeful speculation on both sides of the pacific. In the United States, prominent organizations like the US China Business Council and The Heritage Foundation voiced robust support for including China in the negotiations. In China, prominent economists laid out strong arguments for why the TPP needed China, as well

---

[1] The first invitation arguably came from Hillary Clinton in 2012, but it was not until May 2013 that the White House formally announced its willingness to accept China at the TPP roundtable.

[2] See: Basu Das, Sanchita. 2013. "The Trans-Pacific Partnership as a Tool to Contain China: Myth or Reality?" *East Asia Forum*. http://www.eastasiaforum.org/2013/06/08/the-trans-pacific-partnership-as-a-tool-to-contain-china-myth-or-reality/; Gross, Donald. 2013. "Welcoming China to the Trans-Pacific Partnership." *Huffington Post*, July 9; Shao, Zeyu. 2013. "America Uses TPP to Contain Chinese Manufacturing '美国利用TPP遏制中国制造.'" *E-Manufacturing* 5 (71).

[3] See: Donilon, Thomas. 2013. "National Security Advisor to President Obama Discusses U.S. Policy in the Asia-Pacific Region in 2013." *Asia Society*. http://asiasociety.org/new-york/complete-transcript-thomas-donilon-asia-society-new-york.

[4] See:: Ministry of Commerce: China to Rigorously Study the TPP Possibility "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

as why China needed the TPP. Former World Bank senior vice president Justin Yifu Lin, for example, argued that the TPP would be “fundamentally incomplete without China.”[5] Likewise, China’s chief economist, Ma Jun, argued the TPP could “augment China’s GDP by up to two percent.”[6] Even within the Chinese leadership, the mood for cooperation was in high spirits. As one MOC official put it, “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.”[7] Such statements encouraged many to conclude that political sentiments in China had unambiguously shifted towards joining in on the TPP. As Beijing University’s Huang Yiping put it, "an increasing number of policy advisers are now urging the government to join TPP negotiations as early as possible."[8]

Not everyone, however, agreed. In the first draft of this chapter, delivered in September 2014, we argued that it would be extremely unlikely for China to join the TPP. In particular, we argued that the arguments in favor of China’s joining the TPP not only fail to demonstrate a clear economic benefit for China, they also fail to appreciate the strategic concerns and options entertained by China’s leaders with respect to both international trade and domestic politics. Specifically, we argued that by, endorsing parallel agreements, China’s could join in on the benefits of TPP without actually acceding TPP. Moreover, we argued that doing so would allow

---

[5] See: Lin, Justin Yifu. 2014. “Justin Yifu Lin Says China Should Join TPP/Faculty Viewpoints - National School of Development.” *Beijing University National School of Development - Faculty Viewpoints*. March 5. http://en.nsd.edu.cn/article.asp?articleid=7332.(Lin 2014)

[6] 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/pboc-s-ma-urges-joining-tpp-to-boost-growth-report-shows.html

[7] Ding, Qingfen, and Joseph Boris. 2013. “‘Positive’ Sign on Free Trade Pact.” *China Daily*, July 3.

[8] Yiping, Huang. 2014. “Huang Yiping: The U.S. and China Should Avoid an Economic Cold War.” *Caixin*. February 21. http://english.caixin.com/2014-02-21/100641687.html.

China to better navigate a gradual entry into a TPP-like regime, so as to maximize domestic political objectives.

Our initial skepticism has so far been confirmed in at least three ways. First and foremost, China to date has not joined any TPP related negotiations. Second, China has made lightening progress on at least two TPP alternatives, the Regional Comprehensive Economic Partnership (RCEP) and the Free Trade Agreement of the Pacific (FTAAP).[9] Finally, with *fast-track* authority in hand, the Obama administration has successfully negotiated with its partners a TPP configuration that has no mention of China and is poised to shepherd the deal through the US Congress in early 2016.[10]

And yet, speculations remain that China may still play a part in the TPP. Most recently, prominent western media groups, think tanks, and consultancies have outlined why China *should* be included in the TPP and why it is in fact, eventually, likely to join.[11] Likewise, on October 26th 2015, the *Study Times*, a mouthpiece for the Central Party School, expressed China's continued interest in the TPP, "the rules of the TPP and the direction of China's reforms and opening up are in line…. China should, at an appropriate time, join the TPP."[12]

---

[9] See: Chang, Gordon. 2015. "TPP vs. RCEP: America and China Battle for Control of Pacific." *The National Interest*. Available at: http://nationalinterest.org/feature/tpp-vs-rcep-america-china-battle-control-pacific-trade-14021 (November 9, 2015).
[10] See: Fabian, Jordan. 2015. "Obama to Sign Fast-Track Trade Legislation." *The Hill*. http://thehill.com/homenews/administration/246418-obama-to-sign-fast-track-trade-legislation (November 9, 2015).
[11] See: Caro, Felipe, and Christopher Tang. 2015. "Leaving China Out of the TPP Is a Terrible Mistake - Fortune." *Fortune*. http://fortune.com/2015/10/06/leaving-china-out-trans-pacific-partnership-terrible-mistake/; Editors. 2015. "China Belongs in the TPP." *Bloomberg News - Editorial Board*. http://www.bloombergview.com/articles/2015-10-08/china-belongs-in-the-tpp; Meltzer, Joshua. 2015. "Why China Should Join the Trans-Pacific Partnership." *Brookings*. http://www.brookings.edu/blogs/order-from-chaos/posts/2015/09/21-us-china-economic-integration-tpp-meltzer; Yang, Jing. 2015. "What China Stands to Gain by Joining US-Led Trade Pact TPP." *Southern China Morning Post*. http://www.scmp.com/comment/insight-opinion/article/1859033/what-china-stands-gain-joining-us-led-trade-pact-tpp.
[12] Xu, Chengjin. 2015. "如何面对 TPP (How to Deal with the TPP)." *学习时报 (Study Times)*. http://www.studytimes.cn/shtml/xxsb/20151026/15726.shtml.

For our part, we continue to maintain that such speculations are unwarranted. However, the fact that key TPP players, like John Kerry, are still holding out an open palm to China, means that this conversation is far from over.[13] In this chapter, we review our initial misgivings about the prospects for China joining the TPP in an attempt to move forward a more fruitful discussion concerning China's evolving response to a TPP, for which it has deep concerns but few prospects for joining.

We begin by outlining the various arguments made by proponents of a TPP-plus-China formation. In particular, we address three common claims for why China is likely to join. The first is economic, which, simply stated, argues that China has the most to gain from tariff reductions associated with TPP membership and the most to lose from trade diversion should it not join. A second common argument is that China's failure to join will undermine its reputation as an open and peaceful economic giant, giving regional economies further incentive to invest in economic and security relations with the United States. Finally, proponents point to China's domestic political environment, arguing that joining the TPP could help the current administration push through declared reform objectives, much like WTO accession did for China's previous 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, each is open to reinterpretation. With respect to the economic logic, we show that the gains from trade, as well as the potential losses from trade diversion, are actually less substantial than might be expected. As for China's international reputation, while we agree that joining negotiations would provide a credible signal

[13] Kerry, John. 2015. "Interview With Askar Alimzhanov of Mir TV." Astana, Kazakstan, Kazakstan. http://www.state.gov/secretary/remarks/2015/11/249070.htm.

of China's peaceful aspirations and a better bargaining position on trade and investment, we also point out that China has alternative means by which to influence its neighbors and their negotiations, namely, by offering attractive parallel alternatives to the TPP. Finally, with regards to domestic politics, we agree that joining the TPP would help the regime coordinate reform objectives. But, after examining the actual reform strategies employed by the current leadership, we conclude that comprehensive reform is not their goal, at least not in the short term. Instead, the push for localized Free Trade Zone's (FTZs) and selective restructuring of state-owned assets suggests a more gradual and politically calculated strategy, a strategy that would be severely compromised under TPP obligations.

The chapter 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 Chinese TPP membership by estimating the benefits it would enjoy by joining the TPP and inferring the costs it would incur should it not join. In section three, we assess the international reputation argument by contrasting the TPP with 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 China is unlikely to join the TPP, not for economic or geopolitical reasons, but because TPP requirements would undermine the current administrations domestic reform strategy. Instead, we argue that China is most likely to continue promoting alternatives to the TPP in the hope of 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 indirect involvement with the TPP through alternative regional trade arrangements.

I: The TPP and the China Possibility

The TPP is set to become 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[14], the TPP's formal negotiating partners have expanded from 3 to 12 nations. Once concluded, the TPP trading bloc will encompass 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). In its entirety, the TPP hopes to tackle a litany of trade-relevant issues neglected by previous arrangements along with an array of non-trade issues such as protections for foreign capital, environmental quality, and even cloud computing. The TPP also takes aim at unfair competition from state-owned enterprises and government procurement practices. 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).

Despite the significant prospects, successful negotiation on the TPP seemed a distant possibility for over eight years. This is understandable. Generally speaking, the size and scope of a union is inversely related to the degree of heterogeneity between the countries inside it (Alesina, Angeloni, and Etro 2001), and the TPP pushes the limits in both respects. As currently defined, the TPP includes 12 economies: Australia, Brunei Darussalam, Canada, Chile, Japan,

[14] At the time, negotiations centered on the "Pacific Three Closer Economic Partnership" or TCEP framework, which evolved into the current TPP formation in 2011.

Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. As shown in Table 1, these twelve differ in terms of size, income level, and technological capacity, meaning that the TPP was a hard sell for nearly everyone. Some general points of contention have included IPR provisions that may make pharmaceuticals much more expensive in the poorer countries and language that will make it possible for companies and multinationals to sue governments if they believe their market access is restricted.[15] Even more contentious, perhaps, provisions aimed at eliminating competition from state-owned enterprises posed serious threats to countries with large state sectors, like Vietnam, Singapore, and Malaysia.

Table 1: TPP Negotiating Partners

China's ambivalent position on TPP served to complicate negotiations even further, by raising the prospect of a much larger and more lucrative TPP that included China or simply a larger version of the TPP that included more of the regional economies and fewer American conditions. For instance, countries like Malaysia and Vietnam, who have their own bloated state sectors, welcomed Chinese criticism towards restrictions on government procurement and state-owned enterprises under the TPP. Similarly, Chinese resistance to strict IPR and limits on exchange rate management found support among developing economies in the group (Malaysia, Mexico, Peru, Vietnam).[16] Most importantly, the prospect of China entering the mix gave all parties reason to hold out for a more substantial regional FTA. Here it is important to remember, that China is already the largest regional importer of parts and components and a major importer of commodities. China is also emerging as a primary source of outward FDI to the region,

[15] Pilling, David, and Shawn Donnan. 2013. "Trans-Pacific Partnership: Ocean's Twelve." Financial Times. September 22. http://www.ft.com/intl/cms/s/0/8c253c5c-2056-11e3-b8c6-00144feab7de.html#axzz3ETrOQWV7.
[16] "developing economy" status based on International Statistical Institute classification.

recently surpassing the US as the region's second largest investor after Japan (see Table 2).[17] Moreover, an agreement including China promises the region greater peace of mind that China would remain open to trade into the future, when its economy slows down and its imports begin to overtake its exports (Panagariya 1999).

Table 2: FDI to ASEAN

Two important developments over the past year have fundamentally altered the playing field. First, in December of 2014, a snap election in Japan gave the ruling LDP a powerful mandate with which to ram through the TPP. Likewise, although President Obama continues to face stiff opposition from both Republicans and fellow Democrats, his win on *fast-track* negotiation authority in summer of 2015 means there is little the US Congress can do to derail or delay the bid by early 2016, by which time it must vote on ratification. These two events made it possible for a successful conclusion to TPP negotiations in October 2015, and now leave China with a choice. Either it begins to inch its way into the partnership or it doubles up on efforts to establish parallel arrangements. To predict its ultimate course of action, we break down China's calculus on the TPP, as well as what appears to be its preferred strategy.

II: China's Economic Stake in the TPP

Whether China will actually join the TPP is still unclear, and there are several compelling arguments for why it should. The most prominent of these is the economic argument, the basic claim of which is that China stands to lose out on potential trade benefits and trade volume if it

---

[17] "Foreign Direct Investment in ASEAN – Key Findings." 2014. ASEAN Business News. http://www.ft.com/intl/cms/s/0/8c253c5c-2056-11e3-b8c6-00144feab7de.html#axzz3ETrOQWV7.

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.

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.[18] 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.

[18] Estimates drawn from Petri, Plummer, and Zhai (2014), Table 1, and expressed in 2007 US dollars.

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

Although many aspects of the complex TPP agreement had not yet been fully defined, Petri, Plummer, and Zhai (2014) used 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. They found that 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 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.[19]

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

[19] ibid.

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.

Figure 2: Foreign Investment Inflows to China

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 (Hammer 2006). Although China's reliance on processing trade has fallen over time, in 2007 half of its total exports were processing exports.[20] 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 exports to the United States and 56.6% of its exports to Japan were processing exports. Much of these processing exports were

[20] Statistics on processing trade shares in this paragraph are drawn from Dean, Lovely, and Mora (2009).

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.

However, 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 (Fergusson *et al*., 2013, p.34). 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 confident 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 (Park 2008).

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 the partners have engaged in 21 negotiating rounds to date. The US- CHINA BIT breaks with China's traditional BIT model in at least two significant respects.[21] First, China has agreed that it will negotiate on the basis of a "negative list." This approach allows the BIT negotiations to move forward with exchanges of "negative lists," which detail sectors closed to foreign investors and typically leads to broader liberalization since it requires "opting out" of liberalization rather than "opting in."[22] Second, in 2013 the two countries agreed to talks on the basis of pre-establishment national treatment (PENT). PENT means that foreign investors will be accorded national treatment in the pre-establishment phase of their businesses, affording greater certainty for investments in various sectors. This arrangement represents a major departure from the current Chinese national investment approval

---

[21] Cheek, Marney, 2012, "Why a U.S. – China Bilateral Investment Treaty Matters," *Investment Policy Central*. Available at: http://www.investmentpolicycentral.com/content/why-us-china-bilateral-investment-treaty-matters.
[22] See: "China, U.S. to start negative list BIT negotiation," *Xinhuanet*. July 10, 2014. Available at: http://news.xinhuanet.com/english/china/2014-07/10/c_133472362.htm.

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.

III: International Reputations

Another common argument for why China is likely to join the TPP is that it needs to signal its commitment to free trade and a peaceful rise as a regional superpower. This need is especially pressing given recent spats between China and some of its neighbors, including Japan and Vietnam, both of which are party to the TPP negotiations. In particular, relations between China and Japan strained in 2012, when the Japanese government purchased the disputed Senkaku (or Diaoyu in Chinese) islands from their private Japanese owner.[23] China responded with a new Air Defense identification Zone (ADIZ) over the area and a ramp-up in nationalistic

[23] The Japanese government decision was intended to avert a potentially more controversial move by Tokyo's nationalistic governor Shintaro Ishihara, for further reading see: Perlez, Jane. 2012. "China Accuses Japan of Stealing Disputed Islands." *New York Times*. http://www.nytimes.com/2012/09/12/world/asia/china-accuses-japan-of-stealing-disputed-islands.html.

rhetoric, both of which have further undermined good faith between the two economies.[24] Similarly, in May 2014, China parked a portable oil drilling station in disputed waters within Vietnam's Exclusive Economic Zone (EEZ). The move prompted street protests from Vietnamese citizens who directed their anger towards local Chinese businesses (though many turned out to actually be Taiwanese). Most recently, assertive land reclamation efforts in the South China Sea have added to regional concerns that China's economic pragmatism has given way to geopolitical realism.

Under this tense backdrop, China has been struggling to convince neighbors that, while it remains resolute in pressing territorial claims it is nevertheless committed to economic cooperation. One of the clearest examples of China's softer side is the One Road One Belt initiative, a multidimensional logistics and investment platform, financed by China, that promises billion dollar prospects for China's neighbors, particular in South and Southeast Asia.[25] While this strategy may ultimately pan out quite favorably, it is still too early to tell. Indeed, already we have seen parts of the strategy, such as deep-water ports in South Asia, fall into disarray.[26]

Arguably, joining in on the TPP would be the best way for China to signal its regional benevolence and commitment to economic cooperation. However, the TPP is not the only option China has for sending such 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

[24] See: Fallows, James. 2013. "How to Think About the Chinese Air-Defense News." *The Atlantic*. http://www.theatlantic.com/china/archive/2013/11/how-to-think-about-the-chinese-air-defense-news/281871/.
[25] See: Zongze, Ruan. 2014. "What Kind of Neighborhood Will China Build?" *China Institute of International Studies*, no. March/April: 26–60.
[26] Gueorguiev, Dimitar D., and Janeen Fernando. 2015. *Fish out of Water: China's Economic Diplomacy in Sri Lanka*. Syracuse. Working Paper, presented on November 02, 2015, Moynihan Center, Syracuse University.

negotiation constituents. In 2004, China concluded the China ASEAN Free Trade Agreement (CAFTA) and is poised to adopt a 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. However, it is not clear whether China is interested in, or even capable of, subscribing to such high standards. Chinese trade representatives, for example, have already criticized the "one size fits all" approach to the TPP negotiations, arguing that there are "developed" as well as "developing" countries at the negotiation table and that no single menu could satisfy everyone.

What China is offering is options and it has been busy marketing several alternatives, some of which appear to be resonating with 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" in the TPP initiative.[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 partners. More recently, Japan's chief TPP negotiator remarked 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]

---

[27] As of early 2012, China 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] Etsushi, Tsuru, and Igarashi Makoto. 2013. "China Asserts Self at ASEAN, Seeks Alternative to TPP." Asahi Shimbun. October 10. http://ajw.asahi.com/article/asia/china/AJ201310100071.

[29] Obe, Mitsuru. 2014. "Japan TPP Negotiator Wonders Why Pact Excludes Monetary Policy." Wall Street Journal. http://blogs.wsj.com/economics/2014/07/17/japan-tpp-negotiator-wonders-why-pact-excludes-monetary-policy/.

China's push for TPP alternatives, or "complements," as it prefers to call them, has a simple sales pitch, namely, 'TPP-like trade coordination without the TPP-level of stringency'. In short, China hopes to advance a "win-win" approach to integration that focuses on breadth of membership, not depth of partnership. For example, China has even argued that there are too many overlapping trade arrangements in the region (even though a large portion of them involve China) and that a new mega-FTA would actually simplify matters.[30] This is all fair and good, but 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. Much more than the TPP, RCEP is very much a regionally motivated idea, not a meeting of like-minded economies. China, for instance, stresses 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 feel left behind by the selective annexation of some ASEAN economies into the TPP. RCEP's regional focus also allows for the inclusion of India, which has so far been left out of regional arrangements, including the TPP.

China's compliments, offer several other enticing features. For example, China has called for the adoption 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 sector-specific reductions. For example, RCEP members could focus initial efforts on sectors, such as tourism and textiles, which are relatively

---

[30] Li, Jiabao. 2014. "China Mulls 'Mega' FTA." China Daily. May 2. http://fta.mofcom.gov.cn/enarticle/enrelease/201405/15661_1.html.

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.

In addition to RCEP, China has also expressed interest in speeding up negotiations on the Free Trade Area of the Asia-Pacific (FTAAP), which poses to be the largest RTA in history, both in terms of geography and economic size. Under the "Yokohama Vision," articulated during the 2010 APEC summit, FTAAP was seen as a natural progression from TPP and RCEP that would eventually encompass all the APEC member countries, accounting for about 60% of the global economy. What China is essentially proposing is to skip the warm-up acts and go straight to the main show. Until recently, negotiations were not even supposed to begin until 2020,[31] but again China's leaders have upped the ante by announcing intentions to push towards an FTAAP agreement under the current Chinese administration.[32] Interestingly, the APEC economies, with reservations from the United States, welcomed the idea, announcing in their 2014 communiqué, that the FTAAP arrangement could be established within the next two years, potentially earlier than the TPP.[33]

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, China has nonetheless moved to improve its intellectual and physical investment environment. As mentioned, earlier, China is in the final stages of negotiating a US-CHINA BIT, which will greatly improve

---

[31] http://www.asiapathways-adbi.org/2013/12/a-vision-of-global-free-trade-the-new-regionalism-and-the-building-blocs-debate/

[32] see: Lee, Karl. 2014. "Making Sense of China's Asia-Pacific FTA Agenda." *The Sun Daily*. May 5. Available at: http://www.thesundaily.my/news/1036063.

[33] See: "2014 APEC Economic Leaders' Declaration - Beijing Agenda for an Integrated, Innovative and Interconnected Asia-Pacific." 2014. Beijing. http://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm.aspx.

investment conditions for 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. Chinese interest in reaching a final bilateral investment deal was affirmed by its latest formal offer in the marathon negotiations, which included a reduced list of industry sectors it wants to keep off limits to foreigners.[34] Beijing reportedly regards this investment treaty as a top priority, as it will signal American confidence in the Chinese economy.[35] 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.[36] China is also improving its physical investment environment, enacting labor and environmental standards that even US and European business groups describe as "too stringent."[37] 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, foreign and domestic, 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.[38]

---

[34] Mauldin, William and Mark Magnier, 2015, "U.S., China Make Progress toward Trade and Investment Deal," *The Wall Street Journal,* http://www.wsj.com/articles/u-s-china-make-progress-toward-trade-and-investment-deal-1443208549 (September 25, 2015).
[35] Pei, Minxin, 2015, "US-China Summit: It's Time for some Cautious Optimism," *Fortune*. http://fortune.com/2015/09/28/china-us-obama-xi-jinping-meeting/ (September 28, 2015).
[36] Singh, Manisha, 2015 "Forget the TPP, Let's Talk about the BIT with China," *Forbes*. http://www.forbes.com/sites/realspin/2015/06/24/forget-the-tpp-lets-talk-about-the-bit-with-china/ (January 4, 2015).
[37] EUCCC, "Re: Comments of the European Union Chamber of Commerce in China on the Draft Labour Contract law, April 18, 2006; USCBC, "Comments on the Draft Labor Contract Law of the People's Republic of China" (Draft of March 20, 2006). Available at: uschina.org/public/documents/2006/04/uscbc-comments-labor-law.pdf
[38] See Y. Yi, "China's Legislature Adopts Revised Environmental Protection Law," *Xinhua News Agency*, April 24, 2014, available at http://news.xinhuanet.com/english/china/2014-04/24/c_133287570.htm.; and "Environmental

Already, American business authorities are noting that Chinese authorities are turning away polluting investors.[39]

IV: Domestic Politics and the TPP

One of the great ironies surrounding the TPP negotiations is that the United States, despite serving as lead architect and advocate for the agreement, has been one of the main obstacles towards a negotiated treaty.[40] Indeed, for nearly eight years, domestic U.S. opposition has obstructed bargaining at the international negotiations table. In this respect, at least, the prospect of China joining in the TPP probably complicate the ratification process further, since both houses of Congress have a long-standing 'anti-China' record, and representatives believe that China got an easy pass when it joined the WTO in 2001.[41] Obama's victory in winning *fast-track* negotiations authority in June 2015, have put many of these concerns to rest, however.

Now that the ball is China's court, it is just as important to consider its domestic political constraints, which unfortunately are often overlooked. As a single-party leadership—unimpeded by a formal opposition or the prospects of upcoming elections—it is convenient to conclude that China's leaders face few such constraints.[42] However, China's CCP leadership is not a monolithic force. The country is highly fragmented, both administratively and geographically

---

Protection: Green Teeth," *The Economist*, May 17, 2014, available at www.economist.com/news/china/21602286-government-amends-its-environmental-law-green-teeth.

[39] See: "2013 Investment Climate Statement - China." *U.S. Department of State, Bureau of Economic Affairs and Business*. http://www.state.gov/e/eb/rls/othr/ics/2013/204621.htm.

[40] The TPP did not originate with the US, but it has, since January of 2008, adopted and restructured the proposed pact as a U.S. driven trade initiative. See: Daniels, Chris (10 February 2008). "First step to wider free trade". *New Zealand Herald*. Retrieved 9 February 2008.

[41] Pilling, David, and Shawn Donnan. 2013. "Trans-Pacific Partnership: Ocean's Twelve." *Financial Times*. September 22. http://www.ft.com/intl/cms/s/0/8c253c5c-2056-11e3-b8c6-00144feab7de.html#axzz3ETrOQWV7.

[42] For further reading on domestic political constraints and international bargaining, see: (Putnam 1988)

(Lampton and Lieberthal 1992; Montinola, Qian, and Weingast 1995; Xu 2011), as well as along factional lines (Cai and Treisman 2006; Nathan 1973; Shih 2004). Increasingly, scholars are starting to include 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 much 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 trade liberalization, especially the TPP, which carries specific provisions aimed at countering unfair competition from SOEs. This resistance will not manifest the same way it does in the United States. That is, provincial delegates are unlikely to challenge a TPP initiative in the National People's Congresses (NPC), nor are SOE workers likely to organize demonstrations against trade policy. 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 would pressure the leadership, should it choose to enter negotiations to join the TPP. What can be 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 (Johnson 2012).

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 the SOEs. Some even argue that joining the

TPP would help the regime achieve its reform objectives. For example, during the Chinese Communist Party's 3rd Plenum, held in November 2013, president Xi Jinping made it clear that he envisions market forces to play a leading role in the future of China's economy, i.e., that SOEs will play a smaller role. From this perspective, at least, joining the TPP could be instrumental in forcing SOEs out of lucrative market position. 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. 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 by selling them off, but by reorienting their interests towards investment.[43] 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.[44] This politically tactful approach allows 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

[43] See: Kroeber, Arthur R. 2013. "Xi Jinping's Ambitious Agenda for Economic Reform in China." *Brookings*. http://www.brookings.edu/research/opinions/2013/11/17-xi-jinping-economic-agenda-kroeber (August 18, 2014).
[44] "The Decision on Major Issues Concerning Comprehensively Deepening Reforms in Brief-." 2013. *China Daily*. http://www.china.org.cn/china/third_plenary_session/2013-11/16/content_30620736.htm (September 26, 2014).

compromised by a TPP-style trade agreement that would require China to expose sectors to unfettered foreign investment, thereby undercutting the appeal of the reorientation strategy for SOEs. Moreover, since many of China's largest SOEs operate in politically sensitive industries, like telecom, media, finance, and energy, it is unlikely that the regime will allow foreign investors in anytime soon, especially not if it believes it can liberalize them internally.

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 is 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.[45] 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 more complicated political 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

[45]See: Ningzhu, Zhu. 2014. "China Approves 12 More Free Trade Zones." *Xinhua*. January 22. http://news.xinhuanet.com/english/china/2014-01/22/c_133066293.htm. Note, the government has retracted from this position a little, but most believe the information was valid, albeit premature.

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 Xiaoping'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 specific SEZs and insure their success, thereby fostering envy among those who had not been selected (Shirk 1993). Had Deng chosen to open the economy in one broad stroke he would very likely have faced much stiffer opposition. More importantly, had he chosen to open the economy broadly, Deng would have had far fewer supporters on other aspects of his reform strategy.

Parallels between Xi's political strategy and Deng's are hard to ignore. Take for example Xi Jinping's inaugural tour of Shenzhen, a tribute to a city with deep affection for Deng Xiaoping, who fathered its economic miracle by making it China's first SEZ. Similarly, opening the Shanghai FTZ was clearly tactical. Shanghai is seen as the base of former president 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 appears to be paying dividends. Han Zheng, the current Shanghai Party Secretary and long-time associate of Jiang Zemin, appears to have shed his old patron and pledged allegiance to Xi Jinping.[46] Several of Shanghai's prominent SOEs are also starting to tow the line by selling off stakes to private equity funds.[47] It is unlikely that the leadership will abandon this apparently effective strategy by signing on to the TPP.

Another political strategy that might be compromised by joining a rigid TPP is China's Western Development Initiative, sometimes referred to as the "Go West" policy, intended to accelerate development in western provinces by shifting investment, production, and education resources to the region. Part of this policy involves building up infrastructure connecting

---

[46] See: Han, Zheng (韩正). 2014. "Leaders and Study《韩正为'解放书单'撰文：上海领导干部必须静心读书》." *Liberation Daily 《解放日报》*, July 25.

[47] Inman, Daniel, Chao Deng, and Shen Hong. 2014. "Shanghai Leads the Way in Revamp of China State Enterprises." *Wall Street Journal*. September 17. http://cpc.people.com.cn/n/2014/0725/c64094-25339446.html.

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.[48] 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 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 low, about seventy percent of that in the east.[49] 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 just as they appear to be bearing fruit.

Figure 3: Provincial Foreign Investment Inflows

[48] For further background see: (Tian 2004; Ziran 2002)
[49] See: "Western China: Enhancing Industrial Competitiveness and Employment" UNIDO Technical Report US/CPR/03/051. Available at: Reinhardt, Juergen. 2005. "Western China Enhancing Industrial Competitiveness and Employment: Technical Report." *United Nations Industrial Development Organization*. Vienna: United Nations Industrial Development Organization. Available at: https://www.unido.org/fileadmin/user_media/Publications/Pub_free/Western_China_enhancing_industrial_competitiveness_and_employment.pdf.

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, 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 on land use 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 (Young 2014).

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.[50] Services are also employing an increasing share of the Chinese labor market, surpassing both primary and manufacturing sector employment in 2010 (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 need of reform. TPP standards would certainly go a long way in

---

[50] Rutkowski, Ryan. 2014. "China Chart of the Week: Services Lead Growth as Industry Slows." *China Economic Watch*. September 19. http://blogs.piie.com/china/?p=4058.

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 Perspectives

Without indulging in the broader merits of the TPP as yet another regional trade agreement, on which opinions are hotly divided, this chapter assesses the narrow prospect of China joining into the mix. China's potential entry into the TPP would vastly alter and augment the impact of the pact. In particular, Chinese involvement would expand the TPP's economic girth to roughly fifty-five percent of global GDP and offer the current TPP partners what may be the ultimate bounty, preferential access to China's budding domestic market. There are good reasons to suspect that China might eventually join. In particular, in its role as primary exporter to the region, joining the TPP would be economically rational for China's terms for trade. Similarly, joining the TPP architecture would be diplomatically prudent for China's international reputation, which has suffered as of late. Finally, just as joining the WTO was instrumental in helping China's leaders push through much needed liberalizing domestic economic reforms, joining the TPP today would go a long way in helping the current administration upgrade China's economic profile by stimulating a still nascent services and high techs sector.

For each of the arguments outlined above, we concede that while extant claims are compelling, they are far from convincing. In particular, we argue that China's trade losses from not joining are predictable and negligible while its short-term opportunity costs and political liabilities are indeterminate and potentially quite large. With respect to diplomacy, we concede that China's failure to join the TPP may undermine China's reputation as a *free-marketer*, but we also point out that China's has alternative avenues through which to define its position on free market politics. Finally, while we agree that joining the TPP would serve as a powerful weapon in the current administration's economic reform efforts, we cannot ignore the valuable patronage and policy space the administration would forfeit should it forgo a piecemeal approach to reform and adopt the TPP's blanket provisions on trade and investment.

While we arrive at an unambiguous conclusion - China will not join the TPP - 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, including most of the TPP partners, that it will be indirectly included in the TPP whether or not it is a formal member. As Ikenberry (2014) points 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." In the case of the TPP, even though China is not party to the institutions, it is moving along a similar path as it tries to market its own parallel agreements. This does not mean that the TPP partners are better off without having China as a member. They are not. However, losses from trade creation and trade diversion are unlikely to last for long, since China is actively pursuing alternative arrangements with virtually all the TPP member states.

The end-game outcome 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. China changed this unfortunate pattern by inviting Indian Prime Minister Narendra Modi to the 2014 APEC summit in Beijing and has since strongly supported India's inclusion in ongoing RCEP negotiations. India's inclusion in a regional trade agreement, just like China's, compromises the US's vision of a higher standards trade arrangement. This is perhaps why China has been so eager to push for RCEP. Indeed, China's best-case scenario is not a world without TPP, but rather a world where the TPP makes a slow and soft entry.

Slow and soft, however, is not in the interest of the United States. Indeed, China's apparent efforts to complicate the TPP negotiations have been more than matched by an increased urgency in Washington to settle disagreements with the other TPP partners and secure *fast-track* negotiations authority at home. Importantly, however, competing interests have not boiled over into outright competition. On the contrary, US negotiators have been surprisingly effective at keeping China positively engaged by keeping an invitation open. Likewise, Chinese counterparts have tactfully raised hopes that they might join the TPP. These common interests were in full display during Xi Jinping's visit to the United States in September of 2015, during which he promised cooperation on intellectual property rights and cyber security.[51] Whereas as

[51] "President Xi Jinping's State Visit to the United States." 2015. *White House, Office of the Press Secretary*. https://www.whitehouse.gov/the-press-office/2015/09/25/fact-sheet-president-xi-jinpings-state-visit-united-states (November 13, 2015).

some have interpreted these corresponding overtures as evidence of a possible 'TPP plus China' arrangement, we contend that such configurations are unlikely because they fail to internalize the complex political and economic calculus currently in Beijing.

Now that TPP negotiations have been concluded, however, the pressure is back on China. Assuming that the agreement is ratified by the US Congress, which is highly likely, the TPP will represent a major win for the US and Japan. First, a successful TPP means that China's parallel RTA efforts will have to further converge towards America's vision of free trade in order to be viable. Second, a successful TPP raises the likelihood that Shinzo Abe, Japan's hardline prime minister, will make good on his promise to revive the Japanese economy, thereby bolstering his country's ability to balance China's influence in the region. Third, a ratified TPP will highlight China's lack of progress domestically. It has now been two years since China announced its first Free Trade Zone in Shanghai. Unfortunately, this effort, along with eleven other zones under construction, has failed to attract much excitement or investment.[52] To make matters worse, China's summer stock market woes have knocked the wind out of the current administration's preferred marketization strategy, which was heavily reliant on shareholder discipline.[53]

While these developments do not raise the prospects of a Chinese entry into the TPP, they do put pressure on Beijing to make tangible progress on its various TPP countermeasures. In particular, these include a bilateral trade investment treaty (BIT) with the United States and two regional trade pacts, RCEP and FTAAP. At their September 2015 summit, US President Obama

[52] See: Wildau, Gabriel. 2015. "Shanghai Free-Trade Zone Struggles for Relevance." *Financial Times*. http://www.ft.com/intl/cms/s/0/8cec0faa-6364-11e5-9846-de406ccb37f2.html#axzz3quOPMggX (November 9, 2015).

[53] Barron, Blade Oliver. 2015. "Did China's Stock Market Crash Just End Economic Reform?" *Forbes*. http://www.forbes.com/sites/oliverbarron/2015/07/05/did-chinas-stock-market-crash-just-end-economic-reform/ (November 9, 2015).

and Chinese Premier Xi reiterated that a "high-quality" BIT is the most important item of the bilateral economic agenda.[54] Similarly, members of the RCEP negotiations have expressed a "new urgency" in completing a joint agreement by the end of 2015.[55] Much as the United States felt compelled to make several notable concessions to TPP partners in its final push for agreement in 2015,[56] we speculate that added pressure will encourage China to make similar concessions and peaceful overtures to the US and ASEAN partners in the proximate future.

---

[54] Pei, Minxin, 2015, "US-China Summit: It's Time for some Cautious Optimism," *Fortune*. http://fortune.com/2015/09/28/china-us-obama-xi-jinping-meeting/ (September 28, 2015).

[55] Kim, Jack. 2015. "China-Backed Trade Pact Playing Catch-up after U.S.-Led TPP Deal." *Reuters*. http://www.reuters.com/article/2015/10/11/us-trade-tpp-rcep-idUSKCN0S500220151011#ofdSHpjUPIB8AlLY.97 (November 12, 2015).

[56] Mauldin, William. 2015. "U.S. Reaches Trans-Pacific Partnership Trade Deal With 11 Pacific Nations." *Wall Street Journal*. http://www.wsj.com/articles/u-s-reaches-trade-deal-with-11-pacific-nations-1444046867 (November 13, 2015).

References

Alesina, Alberto, Ignazio Angeloni, and Federico Etro. 2001. "The Political Economy of International Unions." *National Bureau of Economic Research* (No. w8645).

Bhagwati, Jagdish, and Arvind Panagariya. 1999. "Preferential Trading Areas and Multilateralism – Strangers, Friends, or Foe." In *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements*, eds. Jagdish Bhagwati and Arvind Panagariya. MIT Press, 33–100.

Büthe, Tim, and Helen V. Milner. 2008. "The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?" *American Journal of Political Science* 52(4): 741–62.

Cai, Hongbin, and Daniel Treisman. 2006. "Did Government Decentralization Cause China's Economic Miracle?" *World Politics* 58(04): 505–35.

Crane, George T. 1990. *The Political Economy of China's Special Economic Zones*. M.E. Sharpe.

Dean, Judith M., Mary E. Lovely, and Jesse Mora. 2009. "Decomposing China–Japan–U.S. Trade: Vertical Specialization, Ownership, and Organizational Form." *Journal of Asian Economics* 20(6): 596–610.

Deardorff, Alan V. 2013. "Trade Implications of the Trans-Pacific Partnership for ASEAN and Other Asian Countries." *Ann Arbor* 1001(48109-3091).

Fergusson, Ian F., William H. Cooper, Remy Jurenas, and Brock R. Williams. 2013. Congresional Research Service *The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress*.

Fewsmith, Joseph. 2001. "The Political and Social Implications of China's Accession to the WTO." *The China Quarterly* 167: 573–91.

Hammer, Alexander B. 2006. *The Dynamic Structure of US-China Trade, 1995-2004*. United States International Trade Commission.

Ikenberry, G John. 2014. "The Rise of China and the Future of the West." *Foreign Affairs* (January/February).

Johnson, Ian. 2012. "China's Lost Decade." *The New York Review of Books*. http://www.nybooks.com/articles/archives/2012/sep/27/chinas-lost-decade/ (September 27, 2014).

Lampton, David M, and Kenneth G Lieberthal. 1992. "The 'Fragmented Authoritarianism' Model and Its Limitation." In *Bureaucracy, Politics, and Decision Making in Post-Mao*

China, eds. Kenneth G Lieberthal and David M Lampton. University of California Press, 1–33.

Lin, Justin Yifu. 2014. “Justin Yifu Lin Says China Should Join TPP/Faculty Viewpoints - National School of Development.” *Beijing University National School of Development - Faculty Viewpoints*. http://en.nsd.edu.cn/article.asp?articleid=7332 (September 26, 2014).

Malesky, Edmund J., Dimitar D. Gueorguiev, and Nathan M. Jensen. 2014. “Monopoly Money: Foreign Investment and Bribery in Vietnam, a Survey Experiment.” *American Journal of Political Science* 59(2): 419–39.

Minxin, Pei. 2006. *China’s Trapped Transition: The Limits of Developmental Autocracy*. Cambridge, Mass: Harvard University Press.

Montinola, Gabriella, Yingyi Qian, and Barry R. Weingast. 1995. “Federalism, Chinese Style: The Political Basis for Economic Success in China.” *World Politics* 48(01): 50–81.

Nabar, Malhar, and Kai Yan. 2013. *Sector-Level Productivity, Structural Change, and Rebalancing in China*. International Monetary Fund.

Nathan, Andrew J. 1973. “Factionalism Model for CCP Politics, A.” *China Quarterly* (53): 34–66.

Panagariya, Arvind. 1999. “The Regionalism Debate: An Overview.” *The World Economy* 22(4): 455–76.

Park, Walter G. 2008. “International Patent Protection: 1960–2005.” *Research policy* 37(4): 761–66.

Petri, PA Peter A., Michael G. Plummer, Zhai Fan, and Fan Zhai. 2012. Peterson Institute for International Economics *The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment*.

Petri, Peter A., Michael G. Plummer, and Fan Zhai. 2014. “The TPP, China and the FTAAP: The Case for Convergence.” *SSRN Electronic Journal*.

“President Xi Jinping’s State Visit to the United States.” 2015. *White House, Office of the Press Secretary*. https://www.whitehouse.gov/the-press-office/2015/09/25/fact-sheet-president-xi-jinpings-state-visit-united-states (November 13, 2015).

Putnam, Robert D. 1988. “Diplomacy and Domestic Politics: The Logic of Two-Level Games.” *International Organization* 42(03): 427–60.

Shih, Victor. 2004. “Factions Matter: Personal Networks and the Distribution of Bank Loans in China.” *Journal of Contemporary China* 13(38): 3–19.

Shirk, Susan L. 1993. *The Political Logic of Economic Reform in China*. University of California

Press.

Song, Zheng, Kjetil Storesletten, and Fabrizio Zilibotti. 2011. “Growing Like China.” *American Economic Review* 101(1): 196–233.

Steinfeld, ES. 2000. *Forging Reform in China: The Fate of State-Owned Industry*.

Tian, Qunjian. 2004. “China Develops Its West: Motivation, Strategy and Prospect.” *American Economic Review* 13(41): 611–36.

Viner, Jacob. 1950. *The Customs Union Issue*. Carnegie Endowment for International Peace.

Xu, Chenggang. 2011. “The Fundamental Institutions of China’s Reforms and Development.” *Journal of Economic Literature* 49(4): 1076–1151.

Young, Angelo. 2014. “For Chinese Automakers, Profitability Comes From Partnerships By International Business Times.” *International Business Times*.

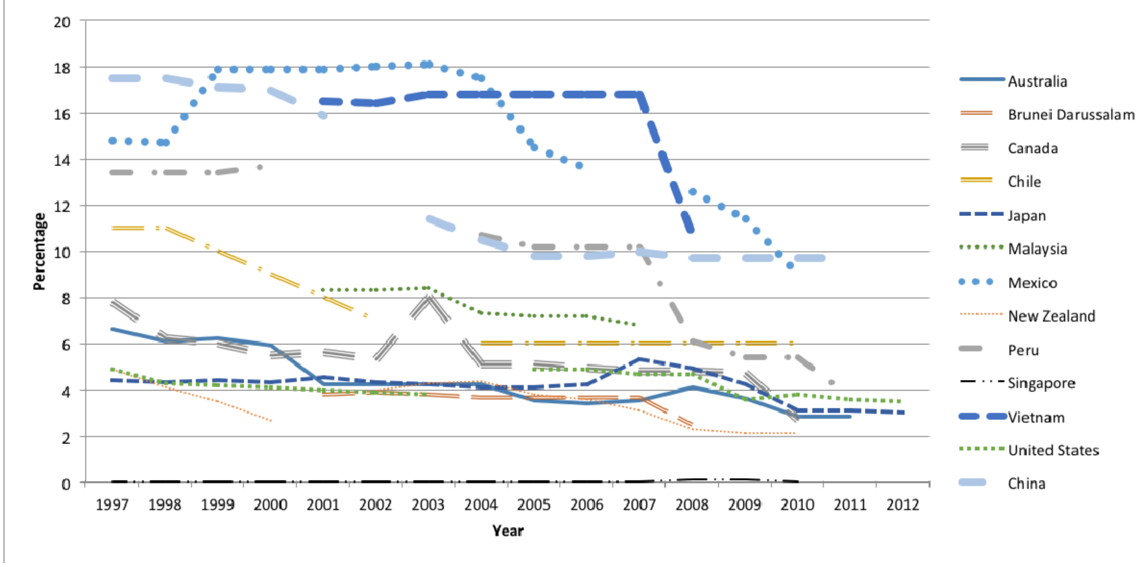
Zhai, Fan. 2008. “Armington Meets Melitz: Introducing Firm Heterogeneity in a Global CGE Model of Trade.” *Journal of Economic Integration* 23: 575–604.

Ziran, Zhong. 2002. “The Chinese Western Development Initiative: New Opportunities for Mineral Investment.” *Resources Policy* 28(3-4): 117–31.

Zweig, David. 2001. “China’s Stalled Fifth Wave": Zhu Rongji's Reform Package of 1998-2000.” *Asian Survey* 41(2): 231–47.

Figures and Tables

Figure 1: Average Simple MFN Tariff Rate on Merchandise Imports, by Year and Country



Source: World Integrated Trade System, World Bank, 2014.

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

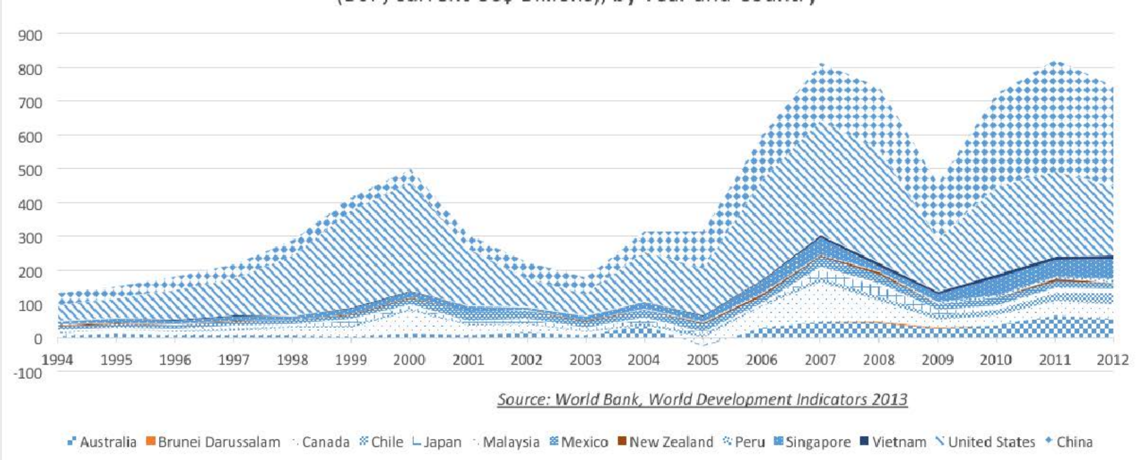
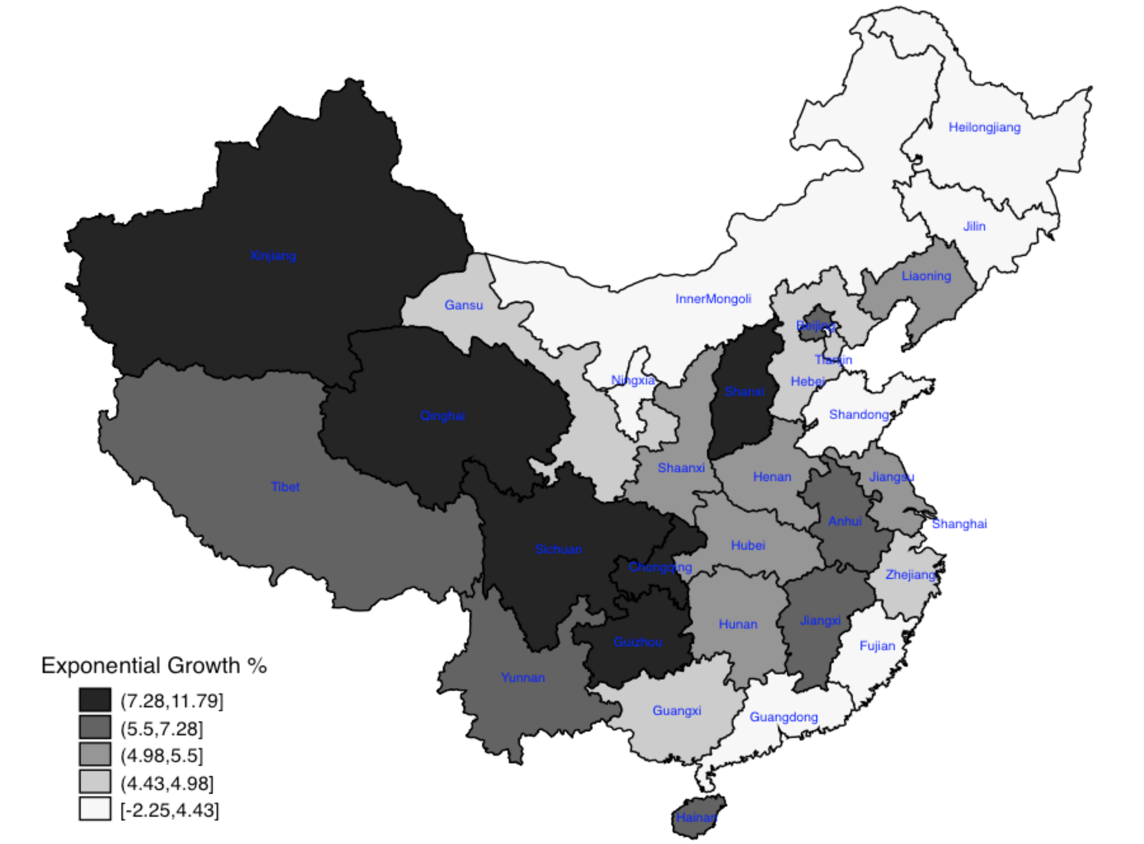
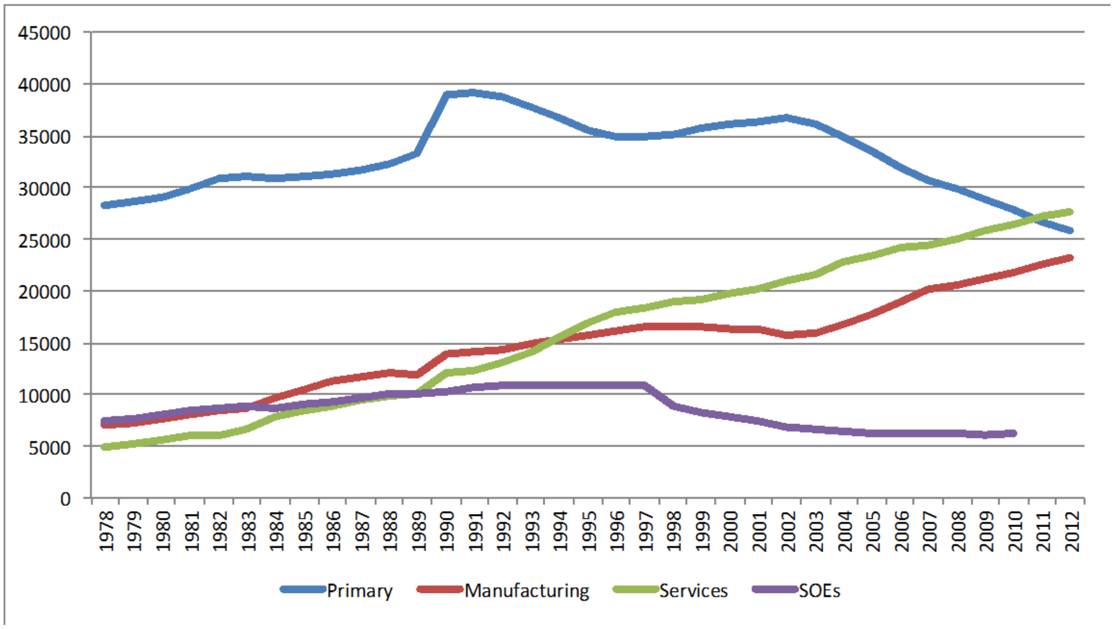


Figure 3: Growth of Provincial Foreign Investment Inflows, 2005-2012



Source: Chinese Statistical Yearbook, 2013.

Figure 4: Employment by Sector



(10000 Workers)
Source: Chinese Statistical Yearbook, 2013.

Table 1: Country Characteristics, TPP-12 Countries and China, 2012

	Country	GDP in billions of 2012 USD	GDP per capita (2012 USD)	Merchandise Export (2012 USD)	Service Export (2012 USD)	Total Exports of Goods and Services (2012 USD)
High	Australia	1532	67436	256	53	309
	Brunei Darussalam	17	41127	13	1	14
	Canada	1821	52409	455	84	539
	Chile	266	15245	79	13	92
	Japan	5938	46548	799	134	933
	New Zealand	171	38680	37	13	50
	Singapore	287	54007	408	119	527
	United States	16245	51755	1547	650	2197
Upper-middle	China	8229	6093	2049	196	2245
	Malaysia	305	10432	227	38	265
	Mexico	1186	9818	371	16	387
	Peru	193	6424	46	4	50
Lower-middle	Vietnam	156	1755	145	10	155

Source: World Bank, *World Development Indicators 2013*

Table 2: ASEAN FDI Inflows, by source, in million USD

	2011	2012	2013
European Union (EU)	29693.3	18084.9	26979.6
Japan	9709.0	23777.1	22904.4
ASEAN	15228.4	20657.6	21321.5
China	7857.7	5376.8	8643.5
Hong Kong	4273.8	5029.9	4517.3
USA	9129.8	11079.5	3757.5
Republic of Korea	1742.1	1708.4	3516.2
Australia	1530.2	1831.0	2002.3
Taiwan, Province of China	2317.0	2242.3	1321.7
India		2233.4	1317.5

Source: ASEAN, *Foreign Direct Investment Statistics Database*

Table 3: Manufactures as Share of Merchandise Trade, TPP-12 Countries and China, 2012

Country	Manufactures imports (% of merchandise imports)	Manufactures exports (% of merchandise exports)
Australia	73	16
Brunei Darussalam	73	4
Canada	76	47
Chile	67	14
Japan	48	90
New Zealand	69	20
Singapore	60	70
United States	70	63
China	55	94
Malaysia	69	62
Mexico	78	74
Peru	73	15
Vietnam	74	69

Source: World Bank, *World Development Indicators 2013*

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

Country	Average 1960-1990	1995	2000	2005
Australia	2.96	4.21	4.33	4.33
Brunei Darussalam	n.a.	n.a.	n.a.	n.a.
Canada	3.00	4.34	4.67	4.67
Chile	2.04	3.91	4.28	4.28
Japan	2.93	4.42	4.67	4.67
New Zealand	2.67	4.01	4.01	4.01
Singapore	1.64	3.88	4.01	4.21
United States	4.14	4.88	4.88	4.88
China	1.33	2.12	3.09	4.08
Malaysia	1.70	2.70	3.03	3.48
Mexico	1.19	3.14	3.68	3.88
Peru	0.59	2.73	3.32	3.32
Vietnam	1.38	2.90	2.92	3.03

Source: W. G. Park, 2008, "International patent protection: 1960–2005," *Research Policy* 37: 761–766