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China's Evolving Views on the TPP and the RCEP

*By Zhao Hong**

EXECUTIVE SUMMARY

- The Trans-Pacific Partnership (TPP) is a 12-country free trade agreement that aims to attain a high standard regarding its reach and provisions. Above and beyond these provisions, it is designed to create a comprehensive, modern template for future FTA negotiations, as well as provide an alternative model for consolidating existing trade agreements.
- For its part, the Regional Comprehensive Economic Partnership (RCEP) will seek to: promote greater regional economic integration; progressively eliminate tariff and non-tariff barriers; and ensure consistency with the World Trade Organization's rules at the same time.
- China is a key member of the RCEP, but has yet to join the TPP. To date, China's responses to the potential challenges that the TPP poses have included developing closer ties with ASEAN, supporting ASEAN centrality, and promoting RCEP. In addition, China has also seriously weighed the costs and benefits of joining the TPP. Its position with regard to the TPP has shifted from being cautious to being positive, as it begins to recognize the agreement's economic importance and potential as a driver for domestic structural reform.

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- The dynamics of having China participate in the RCEP and not in the TPP, and the US in the TPP but not in the RCEP reinforce a view that strategic competition between the two countries has spilled into the trade area. Due to tensions between the two countries, and the desire of each country to shape integration efforts to secure their own interests, the TPP and RCEP have come to be seen as rival trading blocs.
- To be sure, the emergence of two competing visions of the regional trading order was largely a result of misunderstanding and mistrust on both sides. When the US joined the TPP, many of its citizens judged that China would be unable to comply with the agreement's exacting standards. In addition, many Chinese experts advised their government that the TPP was an initiative specially designed by the Americans to isolate China economically.
- In fact, there are complementary elements between TPP and RCEP. Many East Asian countries intend to pursue their interests through participation in both the TPP and RCEP processes. There is therefore space for the US and China to work closely instead to tweak the TPP and RCEP into complementary pathways to Asia-Pacific economic integration.

INTRODUCTION

Asian economic integration used to be market-driven, and East Asian countries have in the 21st century become very active in negotiating Free Trade Agreements (FTAs). The number of FTAs in Asia as a whole has increased dramatically, with 109 now in effect, 75 under negotiation and 50 proposed. In East Asia, there were 67 FTAs in effect, 63 under negotiation and 41 proposed as of March 2013.¹

The benefits arising from FTAs are obvious, and can be economic or non-economic in nature. The economic gains include trade creation, improved terms of trade, increasing returns to economic scale, wealth effects originating from preferential tariffs and reduction of non-tariff barriers, and growing capital inflows. The non-economic benefits include promoting international linkages and peaceful relations among the grouping's members. Indeed, FTAs have political and strategic motivations. ASEAN's success on the non-economic as well as economic fronts suggests that the value of an FTA goes well beyond its direct economic impact.

For its part, China also benefits significantly from FTAs. The country began its efforts to negotiate FTAs after joining the WTO in 2001. The strategy serves China's interests in many ways, including raising market access, promoting domestic market reform, and improving its relations with trade partners, especially its neighboring countries.

However, due to the continuous pursuit of FTAs, East Asia is now faced with the problem of overlapping bilateral trade agreements, often described as the "Spaghetti Bowl" effect. This usually means that one commodity is subject to different tariffs, tariff reduction trajectories, and rules of origin (ROOs) for obtaining preferences. East Asian trading markets have become disordered and transaction costs have increased correspondingly. Hence, the need to move toward an integrated regional FTA has been often emphasized.

THE TPP FROM THE CHINESE PERSPECTIVE

The TPP – a free trade organization that comes under the framework of APEC (Asia Pacific Economic Cooperation) – was launched by New Zealand, Chile, Singapore and Brunei (known as P4) in 2005 and came into effect in 2006. The preliminary motivation of the four countries was to promote free trade movement among member countries, expand economic and trade relations among each party, and accelerate the overall economic development of each member. In 2009, the US joined the P4 and redesigned it to become a high-standard, broad-based regional pact by renaming it as Trans-Pacific Partnership (TPP). Australia, Peru and Vietnam joined shortly

¹ ADB, *Asian Economic Integration Monitor*, March 2013, p.51.

thereafter, followed by Malaysia in October 2010. Canada and Mexico became a member in 2012 and Japan in July 2013.

The TPP is aimed at creating a comprehensive, modern template for future FTA negotiations and consolidating existing trade agreements.²

Its intention to negate the spaghetti bowl effect is however doubted by many.³ For example, the existing complex Rules of Origin (ROO) for textiles and apparel are expected to be incorporated unchanged into the TPP agreement, and will not be replaced by a single, over-arching ROO.⁴ In all previous FTAs, the US had used the “yarn forward” rule which requires that the material (cotton or synthetic fiber) for a textile product be sourced within the FTA area, and representatives of the US textile industry have argued for an even tighter “yard forward” rule to be included in the TPP.⁵ In contrast, some TPP countries, including Vietnam, seek a less restrictive “cut and sew” rule which will allow its products manufactured from materials of non-TPP origin to benefit from the TPP. Therefore, if compromise positions are not reached eventually, the ROOs of TPP will fail to be liberal, effective and simple rules and may become just one more strand of noodle in the bowl.⁶

The TPP is also expected to be more a strategic than economic activity. As a strategic agreement, it is understood as the economic pillar of the US’s so-called rebalancing toward Asia.⁷ Some Chinese scholars believe the US’s real intention is to gain indirect long-term economic and strategic benefits, including helping American enterprises enjoy an enabling FTA environment, and ensuring the US’s role as the rule-maker in regional trade regulations.⁸ Furthermore, the TPP agreement includes provisions for the environment, transparency, labor and intellectual property, and is supposed to help American multinationals and SMEs acquire market access in Asian markets.⁹

² Peter A. Petri, Michael G. Plummer and Fan Zhai, “The TPP and Asia-Pacific Integration: a Quantitative Assessment”, East-West Centre Working Papers, Economics Series, No.119, 24 October 2011.

³ Ravenhill John, “Extending the TPP: the Political Economy of Multi-lateralization in Asia”, Paper Presented in the UNESCAP Asia-Pacific Trade Economists’ Conference on Trade-Led Growth in Times of Crisis, 2-3 November 2009, Bangkok, Thailand.

⁴ Ian F. Fergusson, etc, “The TPP Negotiations and Issues for Congress”, *Congressional Research Service Report*, 13 December 2013, p.32, < http://www.fas.org/sgp/crs/row/R42694.pdf?utm_source=The+Trans-Pacific+Partnership+Would+Destroy+our+National+Sovereignty&utm_campaign=Trans-Pacific+Partnership&utm_medium=email>

⁵ Ibid, p.39.

⁶ Shiro Patrick Armstrong, “Australia the Future of the TPP Agreement”, East Asian Bureau of Economic Research, *Working Paper* No.71, 9 December 2011.

⁷ Ian F. Fergusson, etc, “The TPP Negotiations and Issues for Congress”, *Congressional Research Service Report*, 13 December 2013, p.32, < http://www.fas.org/sgp/crs/row/R42694.pdf?utm_source=The+Trans-Pacific+Partnership+Would+Destroy+our+National+Sovereignty&utm_campaign=Trans-Pacific+Partnership&utm_medium=email>, p.9.

⁸ Wei Lei and Zhang Hanlin, “The Intentions of America’s TPP Strategy and China’s Responses”, *International Trade*, No.9, 2010.

⁹ Shen Minghui, “Meiguo de quyu hezuo zhanlue: quyu haishi quanqiu?” (America’s Regional Cooperation Strategy: Regional or Global?), *Dandai yatai* (Journal of Contemporary Asia-Pacific Studies), No.6, 2013.

More importantly, some contend that the US is pushing for the TPP in order to control the making of future international trade rules. The ongoing negotiations cover not only traditional WTO-plus issues such as financial services, investment, environment and labor, but also many cross-cutting horizontal issues like SOEs, regulatory coherence and SMEs. As noted by Barbara Weisel, the US chief negotiator for the TPP, “the US aim was to reach a set of rules applying to all the Asia-Pacific countries, and any country ready to join must comply with the rules”.¹⁰ While Shen Minghui, a researcher of Chinese Academic of Social Science in Beijing, believes that “given China’s growing economic strength, the effectiveness of US’s ability based on its asymmetric power to hold bilateral negotiations with China has declined rapidly. Only in multilateral trade negotiations and through the formation of trading blocs can the US effectively balance China as the representative of the group of emerging economies, and encouraging them to accept the new trade rules”.¹¹ Nevertheless, the templates negotiated by the US reflect interests common to advanced such as in services, investment, intellectual property, and sometimes agriculture. These high-standard requirements pose real challenges to China and other East Asian developing countries.

The RCEP AS THE NEW INITIATIVE OF ASEAN

In East Asia, although market-driven economic integration has contributed much toward East Asian production networks and supply chains, no significant progress was made in forging a regional FTA until a joint proposal by China and Japan was declared in August 2011 (Initiative on Speeding up the Establishment of an East Asia Free Trade Area and Comprehensive Economic Partnership in East Asia).¹² This was considered as a big step for formulating a broadly-based regional trade agreement in East Asia given the backdrop of the worsening global economic situation and the TPP initiative.

ASEAN responded by introducing the RCEP (Regional Comprehensive Economic Partnership) in November 2011. During the ASEAN Economic Ministers Meeting in August 2012, the guiding principles of RCEP were endorsed. The principles outlined RCEP as a modern, comprehensive, high quality and mutually beneficial regional FTA. It will seek to promote greater regional economic integration, progressively eliminate tariff and non-tariff barriers, and ensure consistency with WTO rules at the same time. Although based on the ASEAN+1 FTAs, RCEP has very different ROOs,

¹⁰ Du Lan, “Comments on US Strategy for Promoting Trans-Pacific Partnership”, < http://www.ciis.org.cn/english/2011-08/03/content_4380581.htm>

¹¹ Shen Minghui, op. cit..

¹² Joel Rathus, “East Asian Free Trade Area: Bank on It”, East Asia Forum, 11 December 2011.

and will encourage rationalization and flexibility and pursue a simplified approach to ROOs which involves harmonized ROOs and co-equality of rules.¹³ Thus, RCEP was fully supported by all ASEAN+6 countries during the EAS Meeting at the end of 2012, in the hope that it will help reduce FTA overlaps.¹⁴

China has shown great interest in the RCEP. For Beijing, the motives are both economic and strategic. Economically, as China tries to rebalance its economic and trade structures, a more integrated East Asian market becomes more essential to its future growth. China intends to deepen economic relations throughout East Asia, especially ASEAN countries. Through the China-ASEAN FTA (CAFTA), both sides have established close linkages in trade and investment. Once that agreement was achieved in 2010, a new platform has been needed to further promote bilateral cooperation. When Chinese President Xi Jinping and Premier Li Keqiang visited Southeast Asia in 2013, they proposed to upgrade the China-ASEAN FTA to promote a new 'diamond decade'. RCEP promises to be the means for deeper regional integration.

Strategically, China prefers the RCEP as the East Asian regional framework. In Beijing's view, joining the TPP will not be easy in the short-term, and the intellectual property and investment protection requirements will pose formidable barriers. The TPP covers not only issues included in a regular FTA, but also provisions that are crucial for the next wave of economic integration. Some of these provisions are difficult for developing countries to satisfy.

For example, the TPP requires members to adopt and maintain strong and enforceable labor provisions, including freedom of association, allowances for collective bargaining and zero tolerance for child and forced labor. "If negotiators hold fast to these requirements, Vietnam will necessarily be barred entry to the partnership",¹⁵ not to mention China and India. In contrast, RCEP's flexibility – for example, allowing for decisions to be made through any agreed modality and enabling special and differential treatment of ASEAN members – enables a more generous consideration of each state's needs and particular circumstances. This contrasts with the US approach to trade relations which requires a uniformity of rules.¹⁶ Hence, China believes that the RCEP can promote East Asian cooperation in a unique East Asian way, built upon the consensus of participants.

In the Chinese view, "the East Asian cooperation should start from a relatively simple 'ASEAN+3' format first, then extend to being 'ASEAN+6', and finally be open to foreign countries such as the US".¹⁷ Considering the large development gap in

¹³ Sanchita Basu Das, "Asia's Regional Comprehensive Economic Partnership", *East Asia Forum*, 27 August 2012.

¹⁴ Ganeshan Wignaraja, "Why the RCEP Matters for Asia and the World", *East Asia Forum*, 15 May 2013.

¹⁵ Khai Nguyen, "Vietnam Risks TPP Slot on Labour Reality", *AsiaTimes online*, 6 March 2014.

¹⁶ Paul Bowles, "China Debates the TPP", *East Asia Forum*, 20 March 2014.

¹⁷ Shen Minghui, "TPP" New challenges for Asian Economies", in *China-Neighboring Asian Countries: Review and Analysis*, edited by Li Xiangyang, Social Sciences Academic Press, China, 2013.

East Asian economies, one high standard FTA can hardly meet the diverse needs in the region. More importance has to be given to traditional trade clauses and market access, and priority needs to be given to balanced development and the investment environment in the region. Thus, issues such as connectivity and infrastructure development can be incorporated in the RCEP. A recent report by the World Bank and the World Economic Forum explains that in Asia even modest improvements in trade logistics will yield economic returns that are far greater than the removing of all remaining tariffs will do.¹⁸

Moreover, China understands that the RCEP will help strengthen ASEAN's centrality. ASEAN centrality has been the stand taken by ASEAN since the launch of ASEAN+3 following the 1997 Asian Financial Crisis. Before that year, only ASEAN was actively engaged in regional cooperation in East Asia, and most East Asian nations function under APEC – an Asia-Pacific framework dominated by the US. By proposing the ASEAN+3 cooperation after the crisis, ASEAN created a functional platform for East Asian cooperation.¹⁹ This function was strengthened further when more ASEAN+1 FTAs were signed and enforced. The RCEP now provides ASEAN with a new platform on which to play out its central role and enables it to bypass the deadlock of China-Japan strategic rivalry, and to take East Asian cooperation to a new level.

CHINA'S CHANGING ATTITUDE TOWARD THE TPP

While China's responses to the challenge posed by the TPP was to develop closer ties with ASEAN, support ASEAN centrality, and promote RCEP, they have also considered joining the Partnership. China's Ministry of Commerce announcement in May 2013 that the country may join the TPP "on the basis of equality and mutual benefit" suggests a shift away from a cautious stance to a more positive one. Chinese Foreign Minister Wang Yi, while outlining diplomatic priorities for 2014, said that "China will face the member states of the TPP talks with an open attitude, as well as other regional or cross-region FTA initiatives".²⁰

There are several factors prompting China to change its attitude to the TPP. First, it has recognized the importance of the TPP to its economy. As Table 1 shows, trade with TPP parties accounts for 33% of China's total trade in 2013 (\$4160 billion). Among its 10 largest trading partners, 5 are TPP member countries (US, Japan,

¹⁸ Andrew Elek, "APEC Leads by Example in Sparking Economic Recovery", East Asia Forum, 17 December 2013.

¹⁹ Wang Yuzhu, "RCEP and ASEAN Centrality: a Chinese Perspective", EAI Brief Background, No.862, 24 October 2013.

²⁰ Frank Ching, "China Flirts with Joining the TPP", *The China Post*, 1 January 2014.

Australia, Malaysia and Singapore), who altogether account for 28% of China's total trade in 2013.

Table 1 China's trade with TPP parties (2013)

	Imports and exports	Imports (billion \$)	Exports (billion \$)	Trade balance (billion \$)	Trade in China's total trade (%)	Imports in China's total imports (%)	Exports in China's total exports (%)
Australia	136.4	98.8	37.6	-61.2	3.3	5.1	1.7
Brunei	1.8	0.09	1.7	1.61	0.0	0.0	0.0
Canada	54.4	25.2	29.2	4	1.3	1.3	1.3
Chile	33.8	20.7	13.1	-7.6	0.8	1.1	0.6
Japan	312.5	162.3	150.2	-12.1	7.5	8.3	6.8
Malaysia	106.1	60.1	46.0	-14.1	2.6	3.1	0.1
Mexico	39.2	10.3	30.0	19.1	0.9	0.5	1.4
New Zealand	12.4	8.3	4.1	-4.2	0.3	0.4	0.2
Peru	14.6	8.4	6.2	-2.2	0.4	0.4	0.4
Singapore	75.9	30.1	35.9	5.8	1.8	1.5	2.1
US	521.0	152.6	368.4	215.8	12.5	7.8	16.7
Vietnam	65.5	16.9	48.6	31.7	1.6	0.9	2.2
Total	1273.6	593.8	771.0	176.6	33.0	30.4	33.5

Source: Based on Chinese Customs Statistics Monthly, December 2013.

Moreover, China has become an emerging outward investor. In 2012, its total outward FDI reached US\$75 billion with total accumulation being \$424.8 billion, making it the 6th largest foreign investor in the world. China's direct investments are also expanding from natural resources to manufacturing and infrastructure, and TPP parties have become important investment destinations for the Chinese. In 2012 the US, Canada, Australia and Singapore were among the 10 largest investment destinations for Chinese enterprises, accounting for 10% of China's total outward FDI.²¹ China is currently also negotiating an FTA with Australia and a bilateral investment

²¹ Ministry of Commerce of China, 2012 *Statistical Bulletin of China's Outward FDI*, September 2013.

treaty with the US. It has agreed in many of its bilateral investment agreements to commitments characteristic of high-standard agreements, including strong investor-state dispute settlement mechanisms.

The TPP investment chapter may advance investment policy consistent with China's interest. It contains important elements, especially in the areas of protection from expropriation, guarantees of equitable treatment, and access to investor-state arbitration should disputes arise. The TPP investment chapter is expected to link together investor protection commitments with market access for goods and services and other disciplines, which should bolster growth for all parties.

Second, Japan's decision to join the TPP is another reason for China to seek inclusion in the Partnership. In July 2013, Japan had formally joined the TPP negotiations, and as the world's third largest economy and now the second-largest TPP member, its participation significantly raised the potential of the TPP which will cover nearly 40% of global economic output and one-third of trade worldwide. Strategically for the US, including Japan in the TPP underpins an already close US-Japan security alliance, cements Japan's economic orientation in a US-led Asia-Pacific agreement at a time when Japan is also participating in a range of other Asian FTAs, and underscores American and Japanese leadership in the region.²²

Japan joining the TPP negotiations, however, presents a range of challenges for Beijing. For Japan, the TPP is a key means for working with the US and taking a leadership role in developing rules for trade and investment in the Asia-Pacific region. As Prime Minister Shinzo Abe stated assertively, "Japan must remain a leading promoter of rules...for trade, investment, intellectual property, labor, environment and the like".²³ Through the TPP, the Japanese have a chance not only to strengthen global rules in these areas, but also to create regulations on new issues such as digital commerce and SOEs. Obviously, Beijing does not cherish such a scenario. Thus, many policy advisors in Beijing have been urging the government to join the TPP as soon as possible, as "China needs to be a part of the rule-making process, not just a passive rule-taker".²⁴

Third, more and more Chinese scholars are pushing for Beijing to join the TPP negotiations as soon as possible. China is after all facing a rapidly-changing trade landscape. Currently, the US is leading three big negotiations in world trade, namely: the Transatlantic FTA Negotiation, the Trans-Pacific Partnership and Global Service Trade Rules Negotiations. China is not involved in any of these. Domestically, China

²² Richard C. Bush and Joshua Meitzer, "Taiwan and the Trans-Pacific Partnership: Preparing the Way", *East Asia Policy Paper*, 3 January 2014, < <http://www.brookings.edu/~media/research/files/papers/2013/10/taiwan%20transpacific%20partnership%20bush%20meltzer/taiwan%20transpacific%20partnership%20bush%20meltzer%20final.pdf> >

²³ Shinzo Abe, "Japan is back", Speech at the Centre for Strategic and International Studies, 22 February 2013, < http://www.mofa.go.jp/announce/pm/abe/us_20130222en.html >

²⁴ Yiping Huang, "Averting Economic Cold War", *East Asian Forum*, 19 January 2014.

is challenged with economic rebalancing and further reform, including liberalization of the interest rate and its current account. The TPP agenda is seen as a vehicle for accelerating domestic reform in much the same way as reformers used the 2001 WTO entry to promote domestic liberalization.²⁵ In particular, they argue that many of the sticky issues in the TPP – such as reform of SOEs, environmental and labor standards, protection of intellectual property rights and liberalization of services trade – are also on China’s own reform agenda. Thus, if Beijing gains TPP membership, it could participate in the negotiations and gain additional momentum for its domestic own reform agenda. As stated by Dan Steinbock, “Such an approach would allow Beijing to accelerate structural reforms correspondingly, while facilitating the shift from cost-efficiencies to innovation-driven competitiveness”.²⁶

CONCLUSION: THE FUTURE OF ASIA-PACIFIC REGIONAL COOPERATION

The dynamics of having China participate in the RCEP but not in the TPP, and the US in the TPP but not in the RCEP reinforce the view that US-China strategic competition has spilled into the trade area. The TPP pursues a high-standard agreement, while the negotiating objectives of the RCEP are modest – focusing on tariff cuts with flexibility. Due to tensions between the US and China, the TPP and RCEP have come to be seen as rival trading blocs.

In fact, the emergence of two competing visions of the regional trading order was largely a result of misunderstanding and mistrust on both sides. If left unaddressed, such a mentality can be damaging to Asia-Pacific regional cooperation and lead to significant disruptions in trade and investment flows. This is understandable, since China is one of the largest export markets for all the individual TPP members, and is also at the center of the Asia-Pacific’s manufacturing chain. Therefore, the development of TPP provisions and their implementation without China divert significant trade away from China, disrupting the region’s supply chain. Likewise, the RCEP can also draw trade away from the US and other non-member economies. Rivalry between the US and China may become the major determinant in shaping the future of the economic architecture of the Asia-Pacific.

²⁵ Ibid.

²⁶ Dan Steinbock, “Should China join the Trans-Pacific Partnership Talks?”, *China-US Focus*, 27 February 2014, <<http://www.chinausfocus.com/finance-economy/should-china-join-the-trans-pacific-partnership-talks/>>.

- To be sure, there are complementary elements between TPP and RCEP. The TPP is largely a rule-based process driven by the US, but it also sets a high-standard and high-speed framework for complete liberalization. While the RCEP is also rule-based, it recognizes the development differences among member countries. Understandably, most countries in East Asia pursue their interests through participation on both the TPP and RCEP. There is therefore space for the US and China to work closely instead to tweak the TPP and RCEP into complementary pathways to Asia-Pacific economic integration.

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