The Trans-Pacific Partnership, China and India

Economic and political implications

Amitendu Palit

ROUTLEDGE

The Trans-Pacific Partnership, China and India

The United States and 11 other countries from both sides of the Pacific are currently negotiating the Trans-Pacific Partnership (TPP). The agreement is expected to set new benchmark for international trade through its comprehensive coverage of issues and binding regulations. It is expected to eventually mature into a regional trade agreement covering the entire Asia-Pacific. As of now, it does not include China and India, the two largest emerging markets and regional economies.

The TPP has generated controversy for its excessive emphasis on trade issues, which have remained unresolved or unaddressed at the WTO due to differences between developed and emerging markets. It has also been criticized for adopting a negotiating style reflecting the US regulatory approach to international trade and also as a geo-political strategy of the United States for supporting its strategic rebalancing towards Asia. From both economic and geo-political perspectives, the TPP has various significant implications for China and India that are examined in the book.

This book sheds light on how China and India's entries in the TPP are mutually beneficial and how both countries can gain from the TPP by gaining preferential access to large markets and using it as an opportunity for introducing more outward-oriented reforms. The book also cautions that the United States must reconcile to the rebalancing of economic power within the grouping that will occur following the entries of China and India. Otherwise, the TPP and China and India might walk divergent paths, and trade and regional integration in Asia-Pacific may not ever converge. This book will interest anyone who wishes to learn more about the TPP and its future implications and challenges, and China and India's roles in global and regional trade.

Amitendu Palit is an economist specializing in comparative economic studies, international trade, regional developments and public policies. His current research is on China–India comparative economic development, trade and regional architectures in the Asia-Pacific and the political economy of economic reforms. He has worked for several ministries in India, particularly the Ministry of Finance, where he worked for a decade. He has several academic publications to his credit. His latest book *China India Economics: Challenges, Competition and Collaboration* was published in 2011.

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For my parents
Kalyani and Dibyendu Palit

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Contents

Figures

Tables

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Abbreviations

AoA	Agreement on Agriculture
ACTA	Anti-Counterfeit Trade Agreement
APEC	Asia Pacific Economic Cooperation
APTA	Asia-Pacific Trade Agreement
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral investment treaty
BRICS	Brazil, Russia, India, China, South Africa
CBM	Confidence building measure
CECA	Comprehensive Economic Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
CEPEA	Comprehensive Economic Partnership for East Asia
CJK	China, Japan, Korea
CLMV	Cambodia, Laos, Myanmar, Vietnam
CPC	Communist Party of China
DDA	Doha Development Agenda
DPJ	Democratic Party of Japan
EAEG	East Asian Economic Group
EAFTA	East Asia Free Trade
EAS	East Asia Summit
EU	European Union
FTA	Free trade agreement
FTAAP	Free Trade Area for the Asia-Pacific
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GI	Geographical indication
GLC	Government-linked company
GPA	Government Procurement Agreement
GPL	Government Procurement Law
ILO	International Labour Organization
IP	Intellectual property
ISD	Investor–state dispute
ITIF	Information Technology and Innovation Foundation
KORUS	Korea–United States Free Trade Agreement

LDP	Liberal Democratic Party
MFN	Most Favoured Nation
MSME	Micro, small and medium enterprises
NAFTA	North American Free Trade Agreement
NAM	Non-aligned movement
NASSCOM	National Association of Software and Service Companies
NME	Non market economy
NTB	Non-tariff barrier
NTM	Non-tariff measure
OECD	Organisation for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
P3	Pacific 3 Closer Economic Partnership
PHP	Preferential Handling Procedure
PPP	Purchasing power parity
PTA	Preferential trade agreement
RCEP	Regional Comprehensive Economic Partnership
ROO	Rules of origin
RTA	Regional trade agreement
S&D	Special and differential
SASAC	State-owned Assets Supervision and Administration Commission
SEI	Strategic emerging industry
SME	Small and medium enterprises
SOE	State-owned enterprises
SPS	Sanitary and phytosanitary standards
TAC	Treaty of Amity and Cooperation
TBT	Technical barriers to trade
TISA	Trade in Services Agreement
TPA	Trade Promotion Authority
TPP	Trans-Pacific Partnership
TPSEP	Trans-Pacific Strategic Economic Partnership
TRIPS	Trade-Related Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
USTR	United States Trade Representative
WTO	World Trade Organization

1 Why TPP, China and India

In one of his speeches during his last year as the director general of the World Trade Organization (WTO), Pascal Lamy drew attention to the 'rising weight of influence of emerging economies' and how such influence has 'shifted the balance of power'.[1] His specific reference was to the rise of emerging market economies like China, India and Brazil who were 'no longer policy takers' and were influencing the course and evolution of international trade in several significant ways.

The rise of emerging markets is one of the most significant contemporary geo-political developments, with profound implications for world trade. The biggest impact of the development has been to introduce a decisive multipolarity in global trade negotiations by dragging the balance of economic power in world trade, traditionally skewed in favour of the United States and EU, closer to an equilibrium. While the emerging markets are yet to acquire the ability to conclusively dominate trade talks and swing outcomes in their favour, their robust economic growth trajectories and rapidly rising shares in global trade, have given them the clout to successfully resist global trade rules being shaped according to developed country preferences. The effect of their strategic rise has been felt most by the WTO, where there was little progress on implementation of the Doha Development Agenda (DDA) and multilateral trade liberalization for several years till the Bali Ministerial in December 2013 due to irreconcilable differences between the developed and emerging market economies.

The changing geo-political balance and the concomitant sluggishness at the WTO has had two major consequences for world trade. The first is a tendency to search for trade liberalization and market access outside the WTO framework. The inclination has led to a sharp increase in regional and bilateral trade agreements, popularly referred to as preferential trade agreements (PTAs), free trade agreements (FTAs) and regional trade agreements (RTAs).[2] No part of the world has experienced the proclivity more than the Asia-Pacific region. While contributing to the growth of a dense and overlapping matrix of trade agreements between economies from the region, resembling the Asian 'noodle bowl' version of what Jagdish Bhagwati described as the 'spaghetti bowl', these agreements have been spurred by the urge to closely integrate regional supply chains through additional preferential market access provisions. While the industrially mature

Asian economies like Japan, Korea and Singapore have been involved in several FTAs and RTAs, China and India have shown considerable proactivity in this regard in recent years and have signed several FTAs and are simultaneously engaged in multiple negotiations with various partners.

The second consequence of the geo-political shift in global economic power towards emerging markets has been a marked disinclination on the part of the United States to provide leadership to multilateral trade talks and the implementation of the DDA (Panagariya 2013). This unwillingness has arguably, been impelled by the realization that its ability to dominate the multilateral trade agenda has ebbed considerably. Time and again, the United States' unsuccessful attempt to frontload the WTO's trade agenda with the WTO plus and extra issues (e.g. intellectual property (IP), government procurement, labour and environment standards) that have either remained unresolved at the WTO or are not part of its work programme, has stirred it to work for its preferred trade agenda outside the WTO. A part of the motivation has been reflected in an increase in the number of FTAs that it has signed or is negotiating. The most substantive manifestation has been in its commitment to mega-regional trade agreements, with the two most important initiatives being the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP). Between the two, the TPP is at a much-advanced stage of negotiations and is expected to conclude soon. While the TTIP is a RTA envisaged between the United States and EU across the Atlantic, the TPP is a RTA aiming to connect countries across both sides of the Pacific. Taken together, the two comprise two arms of the US trade strategy spanning across the Atlantic and the Pacific.

Unlike the TTIP, the TPP has acquired substantial strategic dimensions, both economic and geo-political. From an economic perspective, it is seen as shaping as an agreement that not only includes issues that the United States has had problems in tabling and pursuing at the WTO, but also as a framework modelled on US trade regulations. The immediate inference of such a perspective is that the TPP is not an inclusive grouping; it is inimical to the trade interests of emerging markets in many respects and probably an attempt to impose US trade rules and regulations on the Asia-Pacific without taking note of emerging market sensitivities. From a geo-political perspective, an oft-repeated negative perception about the TPP has been its branding as a security and foreign policy instrument of the United States for consolidating its strategic presence in the region by pulling together a group of 'like-minded' partners and allies.

One of the most conspicuous features of the TPP – and an important factor contributing to its 'anti-emerging market' perception – is the exclusion of China and India. The situation might well change over time and the future might see the TPP including the two largest Asian economies and emerging markets within its fold. As of now, however, the TPP's stated vision of growing into a 'high quality twenty-first century' trade framework for the entire Asia-Pacific seems unrealizable unless it includes China and India. On the other hand, for China and India too, the TPP is an exceptionally significant development. Neither country can afford to overlook its implications, both economic and strategic, given that they aspire to lead the world economy in the coming decades by being among the largest players in global trade and commerce.

This book studies the economic and political implications of the TPP for China and India across several aspects including the possibilities of trade diversion, the consequences for Asian regionalism and the political economy dynamics. In the process, it tries to identify the economic and strategic distance between the TPP and China and India in terms of their regulatory and institutional contrasts and the domestic political economy complexities in the two countries likely to influence perceptions on the TPP. The book also explores the possible strategies of both countries for joining the TPP. The larger context of the examination is based on gathering deeper insights on two fundamental questions: Are the TPP, and China and India, mutually exclusive; and how feasible is it for China and India to join the TPP in the foreseeable future.

The TPP, China and India: mutually indispensable

The sheer economic size of the United States compared with other members, as will be discussed in Chapter 2, was bound to make it the driving force of the agreement. It is hardly surprising therefore that the TPP's interests and ambitions are considered broadly similar to those of the United States and it is being identified as a trade framework symbolizing the US agenda in global trade. Notwithstanding the entry of Japan, the third largest economy in the world, the United States still accounts for 57.1 per cent and 59.6 per cent, measured in nominal and PPP terms respectively, of the economic size of the current TPP bloc. With around three-fifths of the TPP's economic output, the balance of economic power in the TPP is disproportionately in favour of the United States. The slant enables it to have a significant say in shaping the TPP in terms of deciding the negotiating agenda and the course of negotiations. As the largest economy in the TPP, the United States is able to leverage access to its own market as a negotiating chip for obtaining WTO plus market access commitments from other members. The problem with this current characteristic of the TPP is its low credibility as an inclusive trade framework by accommodating heterogeneous economic interests. Such credibility can come only with a more diverse grouping representing trade preferences other than those of the United States.

The economic balance within the TPP would change significantly with the entry of China and India. From almost 60 per cent of the market size of the TPP that the United States has now, its share would drop to 41.8 per cent and 36.3 per cent in nominal and PPP terms if the TPP were to include China and India. As a group by themselves, China and India would comprise 26.9 per cent and 39.1 per cent of the market size of the TPP in nominal and PPP terms.[3] From a multilateral perspective, and particularly those of emerging markets, the TPP would acquire a more egalitarian look and would be conceived of much less as an instrument for advancing US trade interests fashioned by US business lobbies and interest groups. More emerging markets might be encouraged to join the TPP, imparting it a truly plurilateral character. On the other hand, the rather drastic change in economic balance would influence the ability of the United States to decisively dominate the TPP agenda. Whether the United States is prepared to accept such an eventuality is important, as that would be significant in determining the room for emerging markets in the TPP. The likelihood of the United States insisting on a high 'entry fee' in the form of commitment to major changes in domestic regulations is quite strong. This would ensure that the United States influenced domestic regulations in China and India in its preferred manner for guaranteeing preferential access of American businesses in these markets, notwithstanding the lesser influence it might have on TPP decisions following China and India's entries.

In a sense, China and India's entries in the TPP can imply significant diplomatic dividends for the United States. By inviting China in particular to the TPP, the United States would be able to dispel the notions of it being a geo-strategic ploy to contain China by stitching an alliance of US allies, partners and friends. It would also send out positive signals about the United States being keen on making the TPP a genuinely comprehensive trade framework for integrating the Asia-Pacific, as opposed to a design for serving the narrow objectives of supporting its rebalancing strategy towards the region. Both these impressions would serve to strengthen the prospects of greater geo-political stability in the region. By including China and India, the United States would also be able to convince the global trade community about its willingness to engage in trade talks with two countries with whom it has had huge differences on various trade issues and has been at loggerheads in the WTO. Indeed, it could help in addressing the impression that the United States is no longer committed to the WTO because of the influence being wielded by emerging markets; negotiating with China and India at the TPP would convey the United States' alacrity to work with emerging markets, notwithstanding such talks taking place outside the WTO.

The inclusion of China and India would greatly enhance the scope of trade creation within the TPP given the preferential access that bloc members will obtain in the two large markets. At present, the 12-member TPP accounts for around 40 per cent of the global GDP in nominal terms and 35 per cent in nominal terms; these shares would increase to 54 per cent and 64 per cent respectively upon China and India's entries.[4] Needless to say, trade liberalization effected across such a large economic area by eliminating barriers and rationalizing standards and regulations would create enormous trade opportunities within the bloc.

Much as the TPP and the United States stand to benefit by including China and India, clear benefits are visible on the part of the latter as well. The TPP is being negotiated at a time when the world economy is still trying to come to terms with the global economic crisis of 2008. Since the crisis, China and India have also experienced slowdowns in their economic growth, largely due to lack of export demand from economically sluggish Western markets. Indeed, from 2008 onward, GDP growths in both countries have dropped below their long-term average growth rates from 1990 onward (Figure 1.1). Both countries need greater external demand for rejuvenating their economic growths: an important prerequisite in this regard is getting access to new markets. The TPP provides an opportunity to China and India for obtaining preferential access in the large NAFTA market, which has 25.8 per cent (nominal) and 22.9 per cent (PPP) shares in global GDP and around 15 per cent shares in global merchandise and commercial services trades. Neither country has FTAs with NAFTA members till now. For China, the TPP also provides the additional opportunity of obtaining similar access to the Japanese market with which it does not have an FTA. On the other hand, for India, the TPP can provide greater preferential access in the Latin American markets of Chile and Peru, and also in ASEAN (Association of Southeast Asian Nations) members like Malaysia and Vietnam, over and above what it currently has through existing bilateral and regional agreements. Staying out of the TPP can imply adverse prospects for both, with export competitors like Malaysia and Vietnam gaining deeper access in the NAFTA and other TPP member markets; and new standards implemented across the TPP emerging as trade-obstructing barriers. The prospects of trade diversion in this regard for both are discussed in Chapter 3. Minimizing such possibilities, and ensuring their domestic producers get access to supply chains created within the TPP by connecting industries from both sides of the Pacific, should be an important priority for China and India.

The lack of progress on the DDA at the WTO has forced China and India to search for preferential market access through bilateral FTAs and RTAs. Most of these, however, while being relatively exhaustive in coverage of goods, only partially cover trade in services and WTO plus and WTO extra issues. For realizing greater benefits from world trade, both countries need to become part

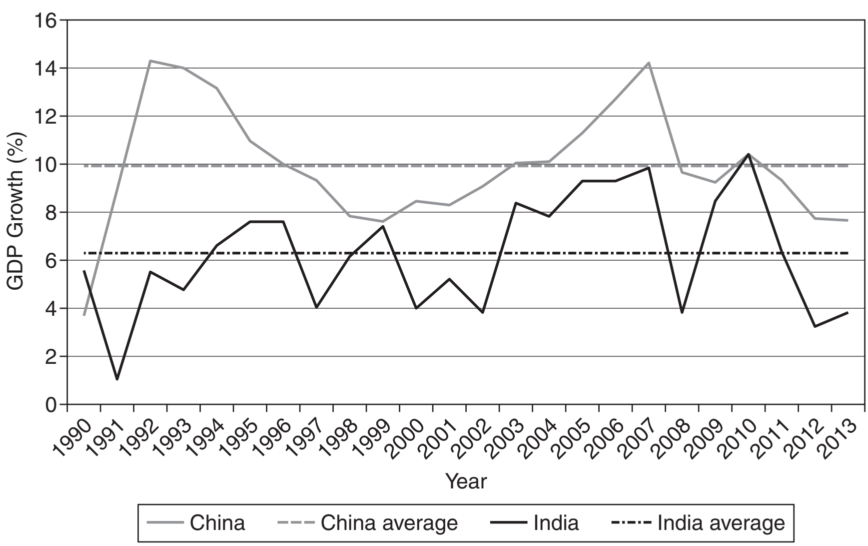

Figure 1.1 GDP Growth trajectories (%) for China and India (source: IMF, World Economic Outlook Database. The changes are for GDP growth in nominal terms).

of trade frameworks focusing on these issues, as otherwise they are likely to fall behind in global trade in services and also become less important players in cross-border flows of investments and finance. In many of the WTO plus areas, China and India have their own views and defensive interests. These interests need to be rationalized in their external trade policies and domestic regulations in a manner that preserves their domestic priorities while maximizing gains from external trade. This can happen only if they become part of frameworks like the TPP that are extensively discussing WTO plus and new generation trade issues and approach these matters constructively. They can no longer afford to sidestep these issues in external trade negotiations as some of their major trade partners, who are already in the TPP, will insist on discussing these issues in the bilateral pacts they have, or are negotiating, with China and India. Both countries must accept the inevitability of future world trade being dominated more by non-traditional issues and should look at the TPP as an opportunity for contributing their own perspectives on these issues, and introducing appropriate changes in domestic regulations. By maintaining a distance from the TPP, both countries risk the possibility of being continued to be labelled as ‘reluctant’ participators in the global agenda for trade liberalization, an impression they have acquired among the developed world and many of their other trade partners due to their occasionally strong defensive postures at the WTO.

As a mega-regional trade deal, the TPP is expected to move towards the Free Trade Area for the Asia-Pacific (FTAAP) by including more economies within its fold. As discussed in Chapter 4, this is a new strand of economic integration initiated in the region, different from the intra-Asian, ASEAN-centric integration initiatives prevailing in the region since the Asian financial crisis of 1997. The intra-Asian initiatives have had China and India playing important roles, particularly at the East Asia Summit (EAS) and the more recent Regional Comprehensive Economic Partnership (RCEP) involving ASEAN and its FTA partners. The RCEP is proceeding parallel to the TPP and may diverge from it if the two become shaped according to structural and issue-based characteristics of the ASEAN and US FTAs. The divergence and possible conflict between the two frameworks will be even greater if the RCEP and the TPP evolve as spheres of strategic influence between China and the United States (Palit 2013b). These adverse outcomes can be avoided if China and India join the TPP. Their entry in the TPP would increase the proportion of common members between the two agreements and would facilitate their eventual merger, paving the way for the FTAAP. In the medium term, China and India’s presences in both the TPP and the RCEP can enable the two frameworks to be complementary to each other by connecting trans-Pacific and Asian businesses through common value chains. Multinationals from both sides of the Pacific can take advantage of the specific benefits of both agreements by dispersing their production along these value chains. As countries with major stakes in the economic integration of the region, China and India can hardly afford to confine themselves only to the Asian track of the RCEP and avoid the TPP; they need to consider the latter as a priority too.