



# Free Trade Bulletin

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## Chinese Free Trade Is No Threat to American Free Trade

by Simon Lester

### Introduction

As debate over the Trans Pacific Partnership (TPP) is heating up, the White House, and some commentators, have weighed in with an argument for this trade pact that has nothing to do with economics: We need the TPP, they say, because without it, China will impose its own trade rules on the region, and those rules will undermine American trade values. According to President Obama, “[W]e have to make sure the United States—and not countries like China—is the one writing this century’s rules for the world’s economy.”<sup>1</sup> Along the same lines, economist Tyler Cowen says: “[E]ither this deal happens on American terms, or an alternative deal arises on Chinese terms without our participation.”<sup>2</sup>

This rhetoric makes it appear as though we are in the midst of a “clash of civilizations” on trade policy. Chinese mercantilism and oppression are up against American free markets and liberty.

The reality of how trade agreements function, and how they relate to one another, is much different. It is true that China is pursuing its own trade initiatives in the region. But China’s negotiations do not threaten American goals. A great thing about free trade is that it is something everyone can enjoy. If Chinese-led free trade helps Asian economies grow, Americans benefit, too. That becomes clear when you understand what China’s trade agreements actually do.

### China’s Trade Negotiations in the Pacific Region

The biggest trade pact China is negotiating is the Regional Comprehensive Economic Partnership (RCEP), which was launched in 2012.<sup>3</sup> The pact is a 16-country negotiation involving the following Pacific countries: the 10 members of the Association of Southeast Asian Nations

(ASEAN), plus Australia, China, India, Japan, Korea, and New Zealand. When people suggest that an “alternative” Pacific trade deal might happen on China’s terms, this is the negotiation they have in mind. To some extent, the RCEP and the TPP have been described as competing visions of Pacific trade arrangements.<sup>4</sup>

In reality, China’s version of a trade deal is not a threat to the TPP. For one thing, it will not be easy to complete the RCEP. Getting India, China, and 14 other countries to agree on the terms of a deal will be challenging and there is still much work to be done. As a result, there may never be an RCEP, regardless of what happens with the TPP. Furthermore, RCEP was, in part, a response to the TPP. If the TPP fails to materialize, as is possible, the motivation for the RCEP might also diminish. Thus, we are not really in a race to the finish here. At this point, there may or may not be a TPP, but the existence of the RCEP negotiations is not a reason for Americans to panic.

Finally, and most importantly, the Chinese approach to free trade (“Chinese terms”) is not some nefarious threat to American values. The RCEP is only in the negotiating stage, so we do not know its precise content, but it is not China’s only trade pact.<sup>5</sup> In the Pacific region, China already has trade deals with New Zealand, the ASEAN countries, and Singapore, among others, and is negotiating with Australia, Korea, and Japan. China also has trade agreements with other parts of the world, including Iceland and Switzerland. As a result, we have a good sense of what China wants in its trade agreements.

What all of China’s agreements do is very similar to what other trade agreements do: among other things they lower tariffs, liberalize services, and encourage the free movement of labor. As an illustration, China has a free-trade agreement (FTA) with New Zealand, and New Zealand has explained the benefits of market opening by China as follows. For trade in goods, China has committed to reducing most of its tariffs:

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[The] FTA will result in tariffs on 96 percent of New Zealand's current exports to China being eliminated over time. The FTA also encourages cooperation between relevant officials, regulators and technical experts to remove non-tariff barriers to trade.<sup>6</sup>

For trade in services, China has promised access to a number of service sectors:

China has also committed to provide national treatment and market access for modes 1–3 services,<sup>7</sup> going beyond its WTO [World Trade Organization] commitments, in the following sectors:

- Computer and Related Services—including software implementation services, data processing services, and input preparation services
- Services related to management consulting
- Education (discussed in further detail below)
- Environmental services—an improved Mode 3 (investment in environmental services) commitment permitting wholly foreign-owned enterprises
- Sporting and other recreational services
- Air transport services—aircraft repair and maintenance services, and air travel computer reservation services, and
- Road Transport services—freight transportation by road in trucks or cars; maintenance and repair of motor vehicles; storage and warehousing services; and freight forwarding agency services.<sup>8</sup>

And for movement of persons between the countries, China has agreed to allow easier travel for New Zealanders:

Under the FTA, New Zealanders visiting China for business purposes, including services suppliers, investors and goods sellers will benefit from faster and more transparent visa application processing.<sup>9</sup>

The RCEP will be no different. New Zealand's Ministry of Foreign Affairs and Trade summarized one of the RCEP negotiating rounds this way:

In Trade in goods, participating countries had a constructive discussion on the modalities for the tariff negotiations, on non-tariff measures, Standards, Technical Regulations and Conformity Assessment Procedures (STRACAP), Sanitary and Phytosanitary Measures (SPS) as well as on Customs Procedures and Trade Facilitation (CPTF) and Rules of Origin (ROO).

On Trade in services, participating countries discussed the structure and elements of the RCEP Services Chapter, areas of market access interests and a number of specific issues at good length. . . .<sup>10</sup>

These are the same sort of technical trade liberalizing processes that take place in trade deals not involving China.

Thus, while those expressing fear of China sometimes appear to be suggesting that China is promoting mercantilism in its trade pacts, that is not the case. If China and its trading partners liberalize trade in the way they are doing, that is great for them, and ultimately for Americans, too. The economic growth that results will give the United States more prosperous markets to trade with.

### Different Approaches to Trade Governance

Of course, there are aspects of U.S. trade agreements that do not feature in Chinese deals. One of the fears people have expressed is that China will take a different approach to certain social issues, such as labor rights and environmental protection. As Ezra Klein puts it:

Here's how the White House sees it: there will either be a trade deal with America at the core of it that forces countries like Vietnam and Malaysia to live up to labor and environmental standards the Obama administration finds acceptable, or there will be a trade deal with China at the core of it that forces countries like Vietnam and Malaysia to live up to labor and environmental standards China finds acceptable. Which would you prefer?<sup>11</sup>

First of all, there is still a healthy debate about whether labor and environment provisions belong in trade agreements. They have the feel of lingering colonialism. The industrialized world did not enforce labor rights and environmental protections during its development period, but now wants to impose these burdens on the developing countries of today. This rubs many people the wrong way.

Putting that aside, what about the concern, among those who want those provisions in trade agreements, that China's approach will undermine ours? It is hard to see how that would happen. Even though China and the United States differ on whether to use trade agreements to push social policy changes on trading partners, China's efforts do not affect us. Our trade deal will almost certainly (based on what was in past trade deals) "force" Vietnam, Malaysia, and others to raise some of their domestic standards. China's deal, by contrast, will probably not "force" anyone to do anything on these issues. It will most likely just not cover these standards, allowing countries to pursue whatever policies they want. If the China trade deal doesn't force Vietnam and Malaysia to do anything on labor and the environment—as China does not really care what they do one way or the other—then they are not prohibited from complying with U.S. standards. The only possible threat here would be if Vietnam and Malaysia rejected a U.S. deal and took only China's deal because China's deal did *not* contain the labor and environment provisions. While anything is possible, that result seems highly unlikely given the desirability of access to the U.S. market.

Despite the way the issue is presented by some commentators, China versus America in relation to Pacific trade is not a clash of civilizations. *The Economist* recently suggested that "Describing regional deals as stumbling or building blocks often misses their real importance. They are also

power bases. Countries use them to project their vision of free markets on to the global economy.”<sup>12</sup> Again, the implication is that Chinese mercantilism is being pitted against American open markets. But the dichotomy is overstated. Most aspects of Chinese and American trade agreements are quite similar, focusing on removing protectionist trade barriers. There are a handful of issues where the United States has added new regulatory issues to the agenda, but the U.S. “vision” is not one based on making markets as free as possible. Rather, to some extent, it is based on interest-group pressure. In trying to build a coalition of domestic support for trade agreements, the United States has inserted into trade agreements a number of domestic regulatory issues that interest groups have asked for: strong protections for labor rights, the environment, and intellectual property rights. At the margins, then, it is true that there are differences in approach, but that is based more on self-interest than on a free-market vision. Note that the United States has pushed hard for rules on state owned enterprises (SOEs), but not on rules for subsidies. It is not a coincidence that the United States has few SOEs (while China and Viet Nam have a lot), but uses subsidies a great deal.

### Trade Agreements as Tools of Foreign Policy

Beyond the issue of different visions for trade agreements, there are also broader foreign policy concerns related to China. As Ezra Klein notes, “TPP is central to the Obama administration’s long-heralded ‘pivot to Asia.’ . . . Americans need to realize that the competition with China, etc., will be about using economic policy as an effective tool of statecraft.”<sup>13</sup> The “pivot to Asia” has been a centerpiece of U.S. foreign policy, and the TPP is often talked about as being a part of it.<sup>14</sup>

Using trade agreements for foreign policy purposes is common, but it is often misguided and can undermine economic welfare. To take one example from recent trade negotiating history, the United States has an FTA with Australia, but not with New Zealand. Why discriminate among these very similar Pacific nations, and limit the scope of trade liberalization? In this case, it was to reward Australia for its support for the Iraq war, and to punish New Zealand for not doing so.<sup>15</sup>

In practice, then, weighing down trade negotiations with foreign policy runs the risk of having foreign policy mistakes undermine our economic policy. Trade policy matters for its own sake: the main goal is to improve economic welfare. Letting foreign policy play too big a role undercuts these economic considerations. Free trade with the Pacific region is good economic policy. The fact that it can strengthen our relationships in the region is a side benefit, of course, but should not be the guiding rationale.

### A Better Approach to Free Trade: Multilateralism

Ultimately, these regional trade initiatives may be a distraction from more beneficial global deals and lead to a complex “noodle bowl” of trade agreements.<sup>16</sup> The proliferation of overlapping, and possibly conflicting, trade agreements is a global problem: it is playing out in Asia through the RCEP, TPP, and various bilateral arrangements. Most

economists agree that this is not what free trade should look like: it requires a trade distorting system of rules of origin that undermines the free flow of goods.<sup>17</sup>

Regardless of what happens with TPP and RCEP, then, the United States and China should not be battling for regional trade supremacy to the extent they are doing so. Instead, they should lead the effort to promote free trade at the global level.

Multilateral trade talks at the WTO have struggled in recent years, but they should not be abandoned: WTO obligations are crucial to disciplining trade remedies and subsidies, areas that bilateral and regional trade agreements largely ignore. Such rules remain essential to the functioning of the trading system, and China and the United States should continue to push for a global framework that works.

### Conclusion

Chinese free-trade initiatives in Asia and the Pacific region should give the United States an incentive to get its own free-trade act together, but not for the reasons suggested by some. Chinese free trade is not a threat to American free trade. The justification for U.S. trade agreements is that free trade is good, not that China is somehow bad. Thus, the TPP should succeed or fail on its economic merits. The concerns about letting China write the rules are misguided. China’s trade rules are not a version of state-led capitalism. They are the removal of protectionist trade barriers, just as our trade rules are.

### Notes

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