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Toward Free Trade and Investment between China and the United States

Summary

China and the United States are the two largest economies in the world, and their sizable two-way trade and investment ties are growing rapidly. They increasingly seek to cooperate on a wide range of international economic, monetary, financial, trade, and environmental issues. They have created an extensive network of consultative arrangements, with over 60 working groups that meet annually on a wide array of topics. They provided joint leadership of the global recovery from the financial crisis of 2008–09.

But they collide on a large and growing number of topics as well, with each expressing concerns about policies of the other. They frequently take each other to the World Trade Organization (WTO) over trade disputes and occasionally retaliate against each other's barriers. Mistrust pervades their economic and security relationship. Their large external surpluses (China) and deficits (United States) constitute a big part of the global imbalances that the G-20 has repeatedly sought to correct to support stability in the world economy.

It is thus both natural and necessary to consider how to improve the future economic relationship between China and the United States. One way to do so is by negotiating a comprehensive China–US trade and investment agreement (CHUSTIA). Such an agreement would be historic, joining the world's two largest economies and a pair of geopolitical rivals with an overall relationship that is crucial for regional and global stability.

Economically, annual exports for each country under a CHUSTIA could increase by as much as $500 billion. US exports to China, which now fall far short of what normal economic relationships would suggest (Baily and Bosworth 2014), could almost double. National income could grow by about 2 percent in

China and 0.6 percent in the United States. The level of productivity could rise by almost 2 percent in China and almost 1 percent in the United States. These would be substantial economic spurs for both countries.

In contrast, China will lose as much as $100 billion of annual income and exports from a Trans-Pacific Partnership (TPP) in which it does not participate. It will also lose considerably from a preferential Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union, its two major export markets. The United States will experience marginal losses from China's own less ambitious preferential trade agreements. A CHUSTIA would enable both countries, especially China, to recoup much of these losses.

A US–China agreement could also help each country achieve its internal rebalancing goals, China toward greater consumption and services and the United States toward larger investment and exports—two highly complementary and mutually reinforcing goals. A critical determinant of the feasibility of a CHUSTIA will be China's ability to accomplish its reform program and whether, like some previous Chinese governments, it sees trade liberalization as a helpful and even decisive support for that process. Taken together, a CHUSTIA and macroeconomic rebalancing could contribute significantly to reducing the global current account imbalances of the two economies and the bilateral imbalance between them. This would create a substantial number of new jobs in the United States. The United States should condition its participation on a Chinese commitment to achieve accelerated rebalancing.

The distributional effects would be mildly positive for US services and agriculture and for Chinese manufacturing, and mildly negative for US manufacturing. The gross and especially net employment effects would be very modest compared to ongoing changes in the giant US economy. About 50 million jobs turn over annually in the United States, of which about 20 million represent involuntary separations. Our estimates suggest that new jobs would be created in export industries that sell more to China—170,000 additional jobs annually, for a cumulative total of 1.7 million over a 10-year phase-in period.

The adverse adjustment effect from a CHUSTIA might range between 100,000 and 170,000 US workers involuntarily separated per year who could not quickly find reemployment, and this effect could last for a phase-in period of 10 years. While the absolute figure is large, it is between 0.5 and 1.0 percent of annual involuntary separations and the cumulative 10-year total of 1.0 to 1.7 million represents at most a little over 1 percent of the total US labor force of 155 million. In many cases, the adjustment would simply reduce, by a small amount, the growth of output and employment in affected sectors. The total estimated permanent US income gains are at least $1.25 million for each involuntary job separation that results from larger US imports from China on account of freer trade under a CHUSTIA.

Nevertheless, the adjustment burdens counsel extended phase-in periods for some aspects of liberalization. Additional support measures from the US government may be needed, particularly for US manufacturing industries that face increased competition from Chinese imports. The United States should adopt a stronger trade adjustment assistance program, or a consolidation of worker training programs as President Obama has proposed, in conjunction with a CHUSTIA or earlier if politically possible.

Beyond the economic gains for both countries, a CHUSTIA should reduce the risk of economic conflict between the countries, limit the discrimination against each other inherent in their current and pending preferential trade deals, and strengthen their overall relationship by reducing the mistrust that now pervades it. A CHUSTIA could provide a major public good for the world by fostering deeper ties between its two largest economies and thus limiting the risk of spillovers from disputes between them.

This book is not arguing for any single path toward greater economic integration. China and the United States could achieve freer trade through either a conventional bilateral agreement or Chinese accession, along with other Asian countries, to the TPP. The TPP could be fused with the Regional Comprehensive Economic Partnership (RCEP) in Asia, if it were concluded in the near future. As chair of the Asia Pacific Economic Cooperation (APEC) forum in 2014, China has proposed a feasibility study of a comprehensive Free Trade Area of the Asia Pacific (FTAAP), which could either subsume TPP and RCEP or stand alongside one or both of them. In any of these cases, China–US side agreements would probably be necessary to address bilateral issues outside the regional framework, such as macroeconomic rebalancing. Similar side agreements were reached when Japan recently joined the TPP talks.

Between themselves, the two countries could approach free trade through either a single comprehensive agreement on all key topics or a step-by-step series of compacts on individual issues, starting with the current bilateral investment treaty (BIT) talks. The latter approach could include, and agree to count, several plurilateral negotiations that are already under way—some with, some without China—and in which China–US agreement will be pivotal for overall success: the Trade in Services Agreement (TiSA), the agreement to eliminate tariffs on the Environmental Goods Agreement (EGA), the second International Technology Agreement (ITA2), and Chinese accession to the Government Procurement Agreement (GPA) in the World Trade Organization (WTO). Stand-alone agreements beyond investment might also be reached on tariffs, agriculture, and government procurement. These could provide building blocks for an eventual comprehensive agreement.

The major US request should be for China to liberalize its rapidly growing services sector, since this could foster a large expansion of US exports and employment opportunities. Services liberalization also would promote major Chinese rebalancing objectives and rapid development of the country's domestic services industry as well so the subject might be another candidate for a self-balancing stand-alone agreement, either bilaterally or through the TiSA talks.

Other priority issues for negotiations would include intellectual property rights (IPR) protection and the investment cluster, comprising state-owned enterprises (SOEs) and competition policy as well as foreign direct investment

(FDI) beyond the BIT, as well as a dispute settlement mechanism to ensure effective implementation of the CHUSTIA. As an FTA partner, China could obtain preferred access to US supplies of natural gas. Broader export control issues, beyond agriculture and energy and especially including high-technology products, are also of high priority to China and must be addressed.

At least two essential issues—cyberespionage and currency—could best be handled through parallel, perhaps multilateral, negotiations rather than a bilateral or regional trade agreement. It would be desirable to address labor and the environment, especially climate change, in a similar manner. Failing such alternatives, all of these would have to be included in a CHUSTIA in light of their high priority in the United States.

Based on the analysis in this study, we recommend that China and the United States pursue the broadest and deepest possible reduction of barriers between their economies through the earliest possible accession of China—along with several other Asian countries—to the TPP. They should seek to negotiate a bilateral CHUSTIA if the regional approach cannot be worked out in a reasonable period of time.

China and the United States are unlikely to embark on a CHUSTIA-like agenda in the near future in light of their current trade negotiations with other countries and the acute sensitivity of many of the issues involved. They should begin paving the way, however, through quiet consultations, perhaps sectoral agreements through ongoing plurilateral negotiations, and new initiatives to clear the decks of big parallel issues. These preliminary steps should help the two countries launch a trade initiative at the earliest possible date.

The Negotiating Background

In 1993–94, China and the United States articulated a vision to achieve free trade and investment between them. They did so when they joined the rest of the APEC forum at its initial summit held in Seattle in 1993, in declaring their objective of "free and open trade and investment in the Asia Pacific region." The following year, APEC leaders gathered in Bogor, Indonesia, and announced the Bogor Goals, an ambitious mandate to achieve free trade and investment for APEC's industrialized nations by 2010, and for developing economies by 2020. Since China was then and remains today a developing country, the year 2020 should be regarded as its relevant target for freeing trade. APEC, with its goal of supporting sustainable economic growth and prosperity throughout the Asia Pacific region, has committed to these Bogor Goals at every one of its annual summits over the past two decades.

Over the past 20 years, there has been considerable progress in reaching this goal. China adopted a number of unilateral trade liberalization programs through the late 1990s and early 2000s, often announcing them with much fanfare at APEC summits. The signal development was China's entry into the WTO, which occurred in 2001 after 15 years of negotiation, and the simultaneous US acceptance of permanent normal trade relations (PNTR) with China.

China slashed many of its tariffs and adopted wide-ranging commitments for additional liberalization as a result.

During this same period, however, China and the United States entered into preferential trade agreements with a number of other countries—14 for China, 20 for the United States—and hence the two countries increasingly discriminated against each other while they continued reducing their trade barriers selectively. Most of the US FTAs were with smaller countries, and China's agreements were relatively shallow in their coverage, so the adverse trade diversion effects on the other superpower were modest. The main, though still mild, exceptions were the US agreements with Canada and Mexico to form the North American Free Trade Agreement (NAFTA) in 1994 and its agreements with Australia in 2007 and Korea in 2012.

The potential for negative developments in China–US trade ties rose dramatically when both decided to launch new preferential megaregional agreements in recent years. The United States reengaged in talks for the TPP, which now includes a dozen APEC members following the addition of Japan in 2013. Successful TPP implementation would cost China about $35 billion to $45 billion in annual income and exports by 2025, given the current group of 12 participants (see chapter 2). Chinese costs could grow to $110 billion per year with plausible early additions to TPP membership, including Korea and Indonesia. The TTIP between the United States and the European Union—China's two largest export markets—adds a further threat of major trade diversion.

For its part, China is actively negotiating its two most important bilateral agreements to date, with Korea and Australia, and has begun talks for a trilateral Northeast Asia compact with Korea and Japan. China is also participating in negotiations with the Association of Southeast Asian Nations (ASEAN) plus six—Australia, India, Japan, Korea, and New Zealand, as well as China—for the RCEP, which would amount to an East Asia Free Trade Area. Any such arrangement is likely to encompass liberalization that is much shallower and less rules-based than the TPP, and will probably take considerably longer to complete. But China's Asia track is clearly counterpoised to the US-led Pacific track, presaging a potentially divisive economic profile for the broader region and for China and the United States in particular (Petri, Plummer, and Zhai 2012). In April 2014 President Xi Jinping also proposed that China and the European Union "actively explore the possibility of a free trade area" and the EU cautiously indicated its "willingness to envisage" such an agreement "once the conditions are right."[1]

At least partly in response to this situation, China and the United States have recently begun a subtle but potentially historic process of pursuing free, or at least freer, trade and investment with each other. They energized talks to

1. Shawn Donnan and Andrew Byrne, "China Courts EU on Bilateral Trade Agreement," *Financial Times,* April 1, 2014.

conclude a BIT in June 2013 at a summit between Obama and Xi; these negotiations completed an 11th round in January 2014. China petitioned to join the plurilateral TiSA, championed by the United States, in late 2013 and participated in a new initiative in early 2014 to reduce tariffs on trade in EGA. Both countries were already involved in efforts to strengthen the GPA and the ITA2, though China's recalcitrance had stalled progress on both as of this writing (mid-2014) and is sending mixed signals on whether Beijing really wants to pursue international economic liberalization in support of its domestic development objectives.

China and the United States are nevertheless already engaged in significant efforts to liberalize trade and investment between them and with other countries on a series of issues that would likely form a major share of any arrangement that they might pursue: investment, trade in services, government procurement, and tariffs on information technology and the Environmental Goods Agreement. In 2013 China began to show considerable interest in associating with the TPP after previously dismissing the pact as a US geopolitical plot designed to "encircle China" (Li 2013). China apparently recognized that it would suffer the major trade diversion noted above and perhaps the disruption of its supply chains if it stayed outside, especially with Japan's entry to the agreement. Chinese authorities also wondered why they could not meet the "21st century standards" of the pact if active participant Vietnam could do so. At APEC meetings in early 2014, China also proposed a feasibility study of moving directly to an FTAAP. China and the United States should build on these evolving developments to seek free trade and investment between them, whether through a bilateral CHUSTIA or China's accession to the TPP. Such an agreement would be the most significant economic compact ever negotiated.

Domestic developments in both countries will be decisive to the feasibility of such a far-reaching idea. In China, the Xi government is actively implementing a wide-ranging program of economic reform that would seem to support, and perhaps benefit from, a new burst of trade and especially investment liberalization. China adopted such a strategy in the late 1990s to reinforce and spur the reforms that President Jiang Zemin and Premier Zhu Rongji were sponsoring at the time, and a number of other countries, most recently Japan under Prime Minister Shinzo Abe, have done so as well. There is potent resistance to some of those reforms, and hence to reductions of trade barriers, by key actors, including some SOEs. And as just noted, there are mixed signals in China's policies governing the variety of trade initiatives now being conducted around the region and the world.

The US situation is complex and somewhat contradictory as well. On the one hand, the Obama administration is pursuing the most aggressive US trade negotiating agenda in at least a generation with the TPP, TTIP, TiSA, and others cited above. The administration views all these steps as important contributions to restoring, and subsequently sustaining, economic growth and job creation in the United States. On the other hand, domestic support for these initiatives is shaky. In early 2014 Congress rejected the administration's request to consider granting new trade promotion authority that would provide a legislative framework for ongoing negotiations. Polls suggest that the public no longer favors trade liberalization, or perhaps even globalization more broadly, and has particular doubts about new trade agreements. NAFTA is still widely viewed as a job-costing mistake that colors attitudes about future deals.[2] The United States is not about to turn protectionist; the absence of broad protectionist reactions was a notable dog that did not bark during the recent Great Recession. But the appetite of the US public and political process for new trade-liberalizing compacts, especially with China, is highly uncertain.

International political and security concerns will also have a major bearing on the prospects for any new China–US economic accord. China's rapid ascension to power challenges US hegemony in Asia and potentially more broadly. The two countries are not adversaries, but they are not allies either, as partner countries in most previous FTAs have been. A CHUSTIA might help allay the bilateral tensions between the two countries, including on issues that range well beyond economics, but China and the United States would have to overcome their suspicions and mistrust sufficiently to launch such an enterprise in the first place, and then carry it through the lengthy and contentious process that is characteristic of any major trade negotiation.

Though we use the term *free trade area* throughout this study, we fully recognize that a move to completely free trade between China and the United States is unrealistic. Very few if any of the world's current free trade areas approximate anything like truly free trade. Thus we will frequently refer to the more accurate concepts of freer trade and investment, or liberalization of current barriers. The broader terms *free trade area* and *free trade agreement* are so common in the discourse on these topics that we nevertheless use them ourselves—though clearly the prospects of negotiations we are investigating, as ambitious as they are, would not in reality go quite that far.

China and the United States are the world's two largest economies and together account for about one-third of world output. They are the two largest trading nations and the two largest recipients of FDI. China is the world's largest exporter and largest or second-largest (to Germany) surplus country. The United States is the world's largest importer and deficit country. A trade agreement between them would be a very big deal for the world economy, with profound effects on both countries. It would open new export opportunities that would accelerate each country's economic growth. It would create new sources of import competition that would strengthen the productivity and competitiveness of each. Like any dynamic economic change, it would require internal adjustment among companies and especially workers. It would reinforce the rebalancing that both the US and Chinese economies need and have been pursuing. However, it would likely require substantial policy changes in

2. For an effective refutation of those criticisms, see Hufbauer, Cimino, and Moran (2014).

both China and the United States, especially coming on top of the other major trade compacts that both China and the United States have been negotiating.

Globalization has contributed, to some degree, to less equal income distribution in the United States, China, and virtually all other countries. There are heated disputes over the extent to which globalization is responsible for greater inequality in the United States, but no doubt about its sign. Major new trade agreements, especially with China, could extend that pattern. Hence additional policy steps will be needed to cope with the distributional implications of any agreement.

But the effect on overall relations between the two countries could be profound. There has never been a comprehensive trade agreement between countries with such different economic systems—one fully marketized and the other still far short of completing its transition from command economy to marketization. There has never been such an agreement between a full-blown democracy and an authoritarian state, or between rivals for global geopolitical leadership, especially an incumbent hegemon and a rising power that has not yet become fully engaged in the global leadership process. Negotiating and then implementing such an agreement would lead to a significant and historic strengthening of ties between China and the United States, despite the bumps in the road that will occur along the way.

The Case for a CHUSTIA

There are six reasons to consider engaging in such a historic venture even though it is a very challenging proposition and is unlikely to eventuate in the near future.

First are the substantial economic gains both countries could reap (see above). The sharp increases in exports would enable both countries to do more of what they do best, expanding their scale of production and jobs in sectors where they have demonstrable comparative advantages. As these sectors pay substantially higher wages than the national average, though income inequality might increase, the composition of employment would shift in desirable directions. Both countries would also see more attractive imports. Consumers would gain from a cheaper and more diversified array of goods and services. Producers could obtain lower-cost inputs for their final products, strengthening supply chains. These cost reductions, plus the enhanced competition from increased trade, would stimulate productivity gains that would strengthen both economies. The level of productivity in the United States would increase permanently by almost 1 percent, a major improvement.

Investment is also important. Sales by US firms in China were estimated at $450 billion in 2013 (US Chamber of Commerce 2013), only about one-third of which derive from exports from the United States. The stock of Chinese direct investment in the United States is also abnormally low and China places very high priority on expanding it. Including investment in a CHUSTIA would be of cardinal importance to both countries, and the current BIT negotiation will be a precursor of what might become possible more broadly.

The second reason to engage in a historic CHUSTIA venture is that the trade and investment liberalization achieved under the agreement would promote and enhance economic reform in both countries. This would add substantially to its direct payoff, as described above, and reinforce some of the top policy priorities of each country's leadership, notably the rebalancing of their economies: China in the direction of more consumption and services, the United States toward more investment and exports. It would follow the pattern of many countries that have pursued trade liberalization to promote reform, including Mexico through NAFTA, Korea through its US FTA, China through its entry to the WTO, and Japan prospectively through its participation in the TPP. This internal rebalancing would contribute to the international rebalancing of the two countries, promoting further reductions of the large Chinese global surplus and the large US global deficit, which take place largely with each other. The microeconomic effects of a CHUSTIA would thus reinforce the macroeconomic dimensions of the rebalancing process, including changes in exchange rates, which have been under way for some time but remain far from complete and must continue.

The third reason is that a CHUSTIA should reduce the risk of conflict between the economic superpowers. The sheer size and rapid growth of China–US trade and investment, along with their two very different economic and political systems, virtually guarantee that there will be frequent disputes between them, as there are now and have been for the past two decades. The current case-by-case method of addressing these problems is not working well, and overall economic relations seem to be deteriorating.[3] China seems unwilling or unable to meet US demands concerning commercial cyberespionage, IPR, SOEs, and exchange rates. The United States resists Chinese entreaties on US policies toward Chinese direct investment in the United States and US export controls. CHUSTIA negotiations could help resolve these contentious issues by providing a coherent and hopefully comprehensive framework within which to address specific problems, and by setting up a dispute settlement mechanism to handle most future disagreements. There now exist numerous consultative mechanisms between the two countries, such as the Strategic and Economic Dialogue and the Joint Commission on Commerce and Trade, but they operate without any agreed substantive context and possess no enforcement mechanisms.

3. Jeremie Waterman from the US Chamber of Commerce, speaking for the US business community, cited several areas of "noteworthy deterioration" in 2013: "antitrust policy implementation, access for express delivery service providers, further restrictions on China's largely closed telecommunication services market and even more stringent restrictions on foreign networks seeking to provide electronic payment services as well as anti-corruption targeted disproportionately on foreign companies." See Jeremie Waterman, Hearing on China's Implementation of and Compliance with Its Commitments to the WTO, statement before the Office of the US Trade Representative, November 8, 2013.

The WTO offers a useful framework of agreed principles and procedures, and both countries have used its dispute settlement mechanism to defuse tensions over some issues. But the WTO rules do not address a large and growing number of the topics of disagreement between China and the United States. A CHUSTIA could provide a supplementary and more promising approach by covering these issues and embedding them in a broader policy context, especially if initiated and consistently nurtured by the top political leadership of each country. There would still be contentious disagreements at all stages of the process, but the record of trade agreements is that they strengthen relations between the participants—sometimes dramatically.

Fourth, a new and improved framework for economic relations between the two countries could provide a bulwark against the very real possibility that security relations will remain conflicted or become even more so in the future. Economic cooperation fosters greatly expanded person-to-person contacts, ranging from corporate investors to tourists. Launching trade negotiations would be a major political act by the two leaderships, forcing each country to view the other as a partner as well as a rival, and to characterize each other in that way publicly, which could have a salutary effect on the overall relationship.

Fifth, a free trade agreement between China and the United States could anchor a healthy new economic architecture in East Asia and the Pacific by providing a practical method for achieving convergence between the two current tracks of economic integration in the region. The Asia-only track is already under way, as noted above, with the China–ASEAN agreement and a number of other bilateral FTAs. It may become generalized in RCEP negotiations. The Pacific track also includes several bilateral FTAs, notably the Korea–US FTA, and would be greatly expanded under a successful TPP.

The main risk of the two-track process, in economic and security terms, is that the two tracks could diverge and become competing blocs. Even though there is likely to be considerable overlap in the membership of the two tracks, their substantive templates will be quite different, with the TPP including more exacting disciplines and rigorous implementation. The APEC goal of forging new institutional linkages across the Pacific, for security even more than economic reasons, could be threatened and even shattered. Another risk from a permanent Asia-Pacific fissure would be the creation of a three-bloc world: the TPP, the RCEP, and the European Union. Such tripartite systems are dynamically unstable because each participant constantly jockeys for the support of one of the others against the third (Krugman 1993). APEC sought to overcome this problem by creating a cohesive Asia-Pacific construct as a single counterweight to the European Union.

It would be highly desirable for the two Asia-Pacific tracks to converge, to reap major economic benefits for all participants and avoid significant new difficulties. Negotiation of an FTAAP, which would essentially mesh the TPP and RCEP, represents one route to convergence. Chapter 2 of our study, however, shows that the economic payoff from adding a CHUSTIA to TPP and

RCEP, for the world economy as a whole and for China and the United States themselves, would be virtually as great as from concluding a comprehensive FTAAP. Moreover, an FTAAP might prove more difficult to negotiate, as it would require more than 25 countries involved in the constituent agreements to adopt another new set of rules and institutional arrangements, largely to satisfy China and the United States, after they had just spent considerable effort working out the RCEP and TPP and winning support for them in their national political processes. It might also prove difficult to fuse the more rigorous standards of the TPP and the presumably looser arrangements of the RCEP.

Another route to convergence between the two current tracks would be for more members of one to join the other. Japan, Malaysia, Singapore, Vietnam, Brunei, Australia, New Zealand, and prospectively Korea are involved in the negotiations for both the TPP and RCEP. As noted, China has begun to show an interest in joining the TPP and other Asian countries would surely follow China, if they do not join on their own anyway. Chinese membership in the TPP would be a plausible alternative to a CHUSTIA for China to achieve free trade and investment with the United States.

Finally, by resolving many of the trade frictions between China and the United States and providing mechanisms for addressing future disputes between them, a CHUSTIA would add to confidence around the world in the prospective stability of the global economy. Conflict between China and the United States is probably the greatest potential threat to the sustainability of international trade, investment, and even monetary arrangements. Henry Kissinger (2013) put it succinctly: "The key to an emerging world order is the relationship between China and the United States. China and the United States cannot solve the problems by themselves but the problems cannot be solved without cooperation between China and the United States … so that cooperation is the great opportunity of our age." A CHUSTIA would be by far the most decisive and credible way to pursue such cooperation and reduce risks. It would represent a global public good of great significance.

The Hurdles

A number of significant hurdles would have to be overcome before China and the United States could seriously contemplate a CHUSTIA. Seven stand out.

First, both countries would face adjustment challenges under an agreement that achieved anything approaching free trade. Our analyses in chapters 2 and 3 show that, in light of the expected economic growth of the two economies, output would continue to expand in virtually all sectors. In the United States, however, baseline employment in manufacturing will continue to decline—albeit at a much slower pace than over the past decade—and a CHUSTIA would modestly accelerate that decline. Based on past experience (Autor, Dorn, and Hanson 2013), wage rates for US workers employed in industries that face competition from China might fall marginally.

As mentioned above, about 20 million Americans are involuntarily separated from their jobs in a typical year, and as many as 170,000 workers would have to change jobs per year as a result of a CHUSTIA during its implementation period, depending on how much liberalization the agreement encompasses. While 170,000 is a large number, some of these changes would be voluntary, and not more than 1 in 100 involuntary employment changes in the United States would result from CHUSTIA implementation. As chapter 3 shows, about one-third of the adjustments could occur through voluntary separation without requiring layoffs. For China, modest dislocations would occur in agriculture and a few services sectors, although China's continued rapid growth, especially in services as that sector sharply increases its share of the total economy, means that total production and employment will continue to rise in virtually all sectors.

There will nevertheless be concerns about adjustment burdens because of the absolute numbers of workers involved. The two governments can address these in the CHUSTIA negotiations by adopting extended phase-in periods for liberalization of particularly sensitive items and industries. A CHUSTIA will also require new domestic policy measures in the United States to improve the overall competitiveness of the US economy and especially to respond to the needs of trade-affected workers. The United States will need to strengthen trade adjustment assistance or put in place a comprehensive new program of worker training, as President Obama has proposed (see chapter 3). Overall US income gains from a CHUSTIA are estimated to total $1.25 million for each job shifted; hence, programs focused on strengthening US competitiveness and particularly helping laid-off workers could be readily financed by drawing on the large aggregate national income gains from the agreement itself.

However, perceptions are at least as important as reality in the politics of trade policy. Widespread views that NAFTA hurt employment in the United States have poisoned its trade politics ever since, most clearly in the cliff-hanger vote on the Central American Free Trade Agreement (CAFTA) a decade later and even with respect to the later FTAs with Peru, Colombia, and Panama. Perceptions of the effects of the TPP, especially on jobs and adjustment requirements, will affect US thinking about a CHUSTIA, since the TPP will almost certainly be concluded before any bilateral or regional approach with China.

Second, the economic relationship between the two countries is very unbalanced. The United States is the world's largest deficit and debtor country, and by far the greatest portion of its imbalance is with China. China has been the world's largest or second-largest surplus country in recent years and most of this is with the United States. Its foreign exchange reserves at $4 trillion are almost four times as large as those of any other nation. The two countries have repeatedly pledged to rebalance their economies, both internally and externally, and their current account imbalances and currency misalignments have come down substantially: China's from 10 percent of its GDP in 2007–08 to less than 3 percent in 2012–13, and the United States' from more than 6 percent at its peak in 2009 to under 3 percent currently. However, the imbalances are still quite large and appear to be increasing again. In 2013 China's trade surplus rose to its highest level since 2008, its reserves rose by a record amount of over $500 billion, and its intervention in the currency markets soared once again, continuing to do so in the early part of 2014, when intervention propelled a renewed renminbi weakening that reversed, at least for a time, the steady appreciation since 2010. The International Monetary Fund (IMF) projects that, at current exchange rates, the Chinese and US current account imbalances will increase substantially in the medium term and that China's surplus will nearly double in size as a share of global GDP in five years. The politically salient bilateral imbalance, even when calculated in value-added terms rather than gross exports and imports,[4] has continued to climb steadily and still exceeds $200 billion annually.

The imbalances, and the currency and other policy distortions that underlie them, add to US reluctance to liberalize trade with China. The imbalances thus will prompt calls for a CHUSTIA to address them directly. Bipartisan congressional majorities in both the Senate and House of Representatives are insisting that "the TPP and all future US trade agreements include strong and enforceable foreign currency manipulation disciplines" to counter the practices that helped produce the US current account deficit and prevent future prolonged misalignments. Recent developments in Japan have generated much of that concern. But Congress would almost certainly insist that a CHUSTIA include an effective currency chapter unless international monetary arrangements can be reformed sufficiently in the near future to deal much more decisively with imbalances. The exchange rate is only part of the overall rebalancing process, albeit an integral part, so the United States should insist that any CHUSTIA or a separate side agreement commit China to substantial further imbalance adjustments and specify metrics against which to judge progress.

We noted above that the internal rebalancing of the two economies that a CHUSTIA would promote would accelerate the needed external rebalancing. Continued renminbi appreciation at its pace of 2010–13, or preferably 2005–08, would be encouraged by the structural changes stemming from a CHUSTIA and would eliminate most or all of China's global surplus over the next few years (Hufbauer and DeRosa 2013), although its sizable bilateral surplus with the United States would almost surely persist. The macroeconomic (rebalancing) and microeconomic (trade policy) dimensions of the relationship could and should proceed in tandem over the coming years.

Third, China and the United States have very different income levels. Parts of China, especially in the major metropolitan centers on its eastern coast, enjoy standards of living that reach middle-income levels. Per capita income in the country as a whole, however, is only about one-eighth that of the United

4. The Organization for Economic Cooperation and Development (OECD) has estimated that China's surplus with the United States would be 25 percent lower if measured in value-added terms.

States and only nearing one-fifth on purchasing power parity (PPP) terms. It will still be only one-quarter as large whenever China's total GDP comes to exceed that of the United States. The maximum previous gap in a major trade agreement was the roughly 5:1 ratio between the United States and Mexico before NAFTA, which sparked considerable resistance to the agreement in both countries.

The income disparity is a major reason why the aggregate benefits of the agreement would be so large, reflecting the countries' complementarity in economic structure and production costs. The disparity also underlines the sectoral restructuring that would be required, however, and thus the opposition in some sectors to the whole idea.

China sometimes argues that the disparity in levels of development justifies its rejection of the 21st century standards on which the United States insists in all its trade negotiations. The United States acknowledges that China would have difficulty adopting and implementing some of these standards at this stage of its development. However, the United States argues that China should continually strive to do so and that adhering to a high-standards agreement would accelerate China's development and promote many of the reforms espoused by its leadership. Vietnam's likely ability to accept TPP standards would suggest that China could do so as well. Many of the standards that China faced in joining the WTO 15 years ago were viewed as quite high at the time; China accepted them, some with substantial transition periods, to strengthen its own economy—though its difficulty in fully implementing some of them, regarding IPR protection and SOEs, raises a cautionary note concerning future agreements. China's current negotiations for FTAs with Australia and Korea, both of which already have high-standard FTAs with the United States, already pull China in this direction. Still, central issues for any China–US trade negotiation would be China's willingness, in pursuing its own national interests, to accept the standards the United States has endorsed, and US willingness, in the interest of reaching agreement with China, to moderate some of its requests.

The fourth hurdle is that China and the United States continue to operate very different economic systems. Prices clearly play a less pervasive role in the Chinese economy than in the United States. There is convergence toward a market system (Lardy 2014), but the absence of reliable price signals can distort economic analysis, such as our own, as well as the economy itself. State capitalism remains a major feature of the Chinese economy and observers fear that trends may be reverting back toward it. Some of the thorniest problems that a CHUSTIA would have to address—support for SOEs, failure to protect IPR, ongoing exchange rate manipulation, and cyberespionage against foreign firms—derive from central features of the Chinese economy. A CHUSTIA could help accelerate marketization in China and spur needed policy reforms in the United States. A key dynamic will be whether the economic reforms of the Xi Jinping government embrace external liberalization with that purpose in mind and whether the US government will recognize and pursue the essential complementary policies at home, such as infrastructure renovation.

Related to economic differences, the different political systems of the two countries constitute a fifth hurdle. This affects direct interactions between the governments in both negotiating and implementing any such agreement, as "authoritarian systems are intrinsically less transparent" (Lieberthal and Wang 2012, ix). Many top Chinese officials also apparently see the world in zero-sum terms (Lieberthal and Wang 2012, 29 and 31) while most Americans view international cooperation as a positive-sum game. In modern times, there has never been an FTA on anything like the scale of a possible China–US agreement between an authoritarian regime and a democracy.[5] The political differences between them could greatly complicate efforts to negotiate a mutually beneficial agreement.

A sixth difficulty is that a CHUSTIA would bring together, also for the first time to anything like this degree, major geopolitical rivals. One has to go back to the 19th century to find a rough parallel: The Cobden-Chevalier Treaty significantly reduced tariffs between the United Kingdom and France in 1860 when war between them was a real possibility. Germany and the United Kingdom were major trading partners in the run-up to World War I but never had a trade agreement.

The current situation is even more complicated because it brings together an incumbent global hegemon and a rising, credible candidate for world leadership that has already become an economic superpower. We know from history that integrating new powers into global leadership structures—whether political, economic, or related to security—is one of the most difficult and important challenges to international governance (Gilpin 1981). The failure to incorporate Wilhelmine Germany and to some extent the protectionist United States into the late 19th century global system contributed to the breakdown of the first era of globalization and subsequent massive conflict. Similar failures after World War I gave rise to Nazi Germany and Imperial Japan. The postwar experience with the European Union and democratic Japan, in which trade and economic agreements played an important part, has clearly been far better.

China and the United States negotiating an FTA in light of historical precedents would be a novel approach. As the incumbent power, the United States has written most of the current rules of the game. As an ascending power, China often feels aggrieved by being asked to play by those rules when it has no authorship of and perhaps not even much familiarity with them. A CHUSTIA would accurately reflect the centrality of economics in both the China–US relationship and today's globalized world, and offer a unique opportunity for the two economic superpowers to write new rules together, forging agreement where none existed previously, such as cybersecurity and climate change.

5. The United States has negotiated FTAs with "soft" authoritarian regimes, such as Morocco, Singapore, and arguably Mexico, when NAFTA was signed.

The final and most powerful hurdle, however, may be the pervasive lack of trust between the two countries (Lieberthal and Wang 2012). Many Chinese, including important elites and leadership groups, continue to believe that the United States seeks to limit their national rise and to surround them with its alliances. Many Americans believe that China is purposefully pursuing global domination at US expense or at least wants to eliminate the United States as a power in Asia. Both perceptions are all the more powerful by virtue of having some basis in reality.

The distrust permeates the economic relationship as well. Many Chinese see US unwillingness to sell them high-technology products, or to permit them to invest in sensitive US industries, as evidence of a strategy of containment reminiscent of the Cold War. Many Americans see China's support of SOEs and continued rejection of key market-oriented reforms as indicators of a mercantilist mindset more preoccupied with national military and economic strength than the welfare of the population. The problem extends to each party's doubts about the other party's sincerity in faithfully implementing commitments. China doubts that the United States will really liberalize its export controls or investment policies despite repeated US declarations of an intent to do so. Americans often charge that China has not fulfilled obligations that it accepted over a decade ago when joining the WTO and are skeptical that its repeated declarations to rebalance its economy, and stop relying on trade surpluses and an undervalued currency, will ever be realized. Some Americans believe that China cynically tries to get the best of both worlds, taking full advantage of the openness of the global economy to spur its growth and development but cheating on the rules of that system when it can get away with doing so, as on currency and IPR protection.

The mistrust between China and the United States has taken a sharp leap upward in both countries. In 2012, Kenneth Lieberthal and Wang Jisi had already concluded that "strategic distrust will inevitably impose very high costs on all concerned if it continues to grow at its current rapid pace" and that "it is possible that growth in strategic distrust cannot be avoided" (Lieberthal and Wang 2012, 39). Even more recently, the increasing prevalence of cyberattacks from China, especially for commercial spying, has elicited a wave of US hostility against espionage in an area widely regarded as beyond acceptable boundaries. Revelations of global snooping by the US National Security Agency (NSA) have added to the sense in China and around the world of unbridled US interventionism, power, and hypocrisy.

As a concept, mistrust is as elusive to analyze as it is pernicious to a relationship and difficult to overcome. But it "can produce, over time, a self-fulfilling prophecy of antagonistic relations that are basically zero sum on all sides" (Lieberthal and Wang 2012, 39). The clear presence of bilateral mistrust suggests a need for confidence-building measures wherever possible, as in the relatively modest steps that the two countries are now undertaking in BIT and green goods negotiations. They must keep this underlying reality in mind when deciding whether and, if so, how to pursue the ambitious designs this study addresses.

In addition to the above hurdles to a CHUSTIA, there are important intellectual hurdles to the type of analysis in this book. Most of the underlying data are relatively solid, although there are questions about both the accuracy and objectivity of some of the Chinese numbers. Our economic models, however, while state-of-the art in a technical sense, necessarily rest on assumptions that do not always reflect the real world. The standard model used to estimate trade, growth, and job effects assumes for methodological reasons that trade agreements are long-term propositions that produce no net changes in trade balances or national employment levels. We respect those constraints but temper them with obvious realities that can change the results, such as the possibility that a CHUSTIA would be accompanied by rebalancing measures to reduce US trade deficits and Chinese trade surpluses (see chapters 2 and 17).

The results derived from economic models are only as good as the numbers plugged into them. In our case, it is very difficult to quantify the degree of restrictiveness of many nontariff barriers, especially for services trade, an important component of China–US trade. Hence we candidly characterize some of our results as rough guesses to alert readers to the high degree of imprecision in those findings. Chapter 2 reports sensitivity tests of several analyses, concluding that they could be as much as one-third off in either direction. There are many things we do not know about the underlying economies, including some of the factors that limit trade and especially investment, that may affect the variables we address. There are, in sum, significant shortcomings in our—and everybody else's—analyses of these issues, and they should not be interpreted as precise point estimates of likely outcomes. However, we believe that both the directions and orders of magnitude that we derive throughout this study are correct. They are consistent with both economic theory and intuition, and most are supported by previous analyses of the relevant data.

Another methodological issue bears mentioning. We have attempted to present the CHUSTIA issue in a balanced manner, taking full account of both the Chinese and US perspectives in addressing it. To that end, we have consulted actively with a large number of Chinese officials and experts on the numerous topics involved. However, we understand US viewpoints much more thoroughly and our presentations undoubtedly reflect that bias. We hope that this study will induce some of our Chinese counterparts to prepare parallel analyses, correcting where we may err in depicting Chinese points of view and otherwise lending their sense of equilibrium to the discussion.

The Economic Context

The contest between considerations for and against a CHUSTIA will play out against a very rich and robust, if also contentious and often tendentious, economic situation. China and the United States are the two largest economies in the world and are likely to remain in those positions for the indefinite future. Excluding the European Union as a group, they are the largest global traders. Trade between China and the United States already totals over $600 billion per year and reasonable projections suggest that, largely because of continued rapid growth in China, it will almost triple over the coming decade even without any new liberalization agreements. What China and the United States do together, or in conflict with each other, thus will have substantial worldwide ramifications. They already decisively determine the outcomes of most global trade and other economic negotiations, as well as the fate of international economic institutions; it is difficult to imagine the effective resolution of any global economic issue without US and Chinese concurrence.[6]

But the world economy affects China and the United States at least as much as they affect the world economy. China is one of the most open economies in the world, in terms of the share of trade in a country's GDP. It courageously embraced globalization as a central element of its development strategy, reducing its tariffs and other trade barriers well below those in any other large developing economy. Chinese authorities, led by President Jiang Zemin and Premier Zhu Rongji, deliberately used trade liberalization to promote domestic economic reform in the late 1990s and early 2000s, imposing the new international rules on provincial and party leaders around the country. They made concessions greater than those of any other developing country when joining the WTO. Inward direct investment became a key driver of technology transfer, export prowess, and job creation. China's embrace of the world economy was hugely successful, though it overdid globalization in one sense by relying so heavily on large and growing trade surpluses to sustain its growth rate over much of the past decade.

A key question today involves the interaction between the reforms President Xi has promised and China's international position. Those reforms, and especially their focus on boosting consumption and the services sector, should permit and encourage external liberalization. As in earlier periods, further increases in integration with the world economy would promote the leadership's reform agenda by supporting this rebalancing of the domestic economy and consequently its external economic position. Recent indications of increased Chinese engagement in international trade activities, such as its interest in the TPP and green goods initiative, meaningful talks with the United States on a BIT, and launching the Shanghai Pilot Free Trade Zone, suggest some coincidence between internal and external reform—though China's reluctant stance in the ITA2, GPA, and perhaps the TiSA talks suggests hesitation as well.

6. This is the essential case for creating an informal but very active G-2 between China and the United States (as initially proposed in Bergsten 2005). Such a relationship seems to be developing in process terms: President Obama has met with his Chinese counterparts on an average of every quarter since he took office over five years ago, and there are more than 60 regular bilateral dialogues between the two countries every year. Meetings of the mind on substantive issues have obviously progressed much less rapidly.

We suspect that the interaction will go far to determine China's attitude toward negotiating closer economic ties with the United States. If the leadership decides to push for structural reform, and that external liberalization can be an important driver thereof, then initiatives previously thought to be highly unlikely may become quite realistic. Domestic interests always determine international stances on such issues, and a CHUSTIA is no exception.

For its part, the United States has globalized faster than any high-income country in modern times. Including investment income, the share of trade in its economy quadrupled from 1960 to 2010 to a level of about 40 percent, considerably higher than for the European Union or Japan—though still less than China's level, which is well above 60 percent. About one-fifth of all US manufactured output is exported, generating millions of jobs in that key sector, and the potential for adding jobs in the service sector through increased sales abroad is enormous (Jensen 2011).

A Peterson Institute for International Economics team calculated in 2005 that the US economy was $1 trillion per year richer (in 2004 dollars) as a result of its integration with the world trading system over that same 50-year period, adding almost $10,000 or 10 percent to average household incomes (Bradford, Grieco, and Hufbauer 2005). That team also calculated that annual gains of another $500 billion were available from eliminating remaining trade barriers. This study suggests that as much as one-third of that total could be obtained from the posited liberalization with China.

The United States is in great need of rebalancing and further trade expansion to boost its tepid growth rate and help reduce unemployment, which remains stubbornly high. Fiscal policy will remain restrictive for at least several years, to restore a sustainable profile to the national debt, and will not have much scope for stimulus over the longer run due to the budgetary costs of an aging population. Monetary policy is very near its zero bound, and quantitative easing is already being phased down, so interest rates are likely to rise when the world economy strengthens. Meanwhile, the US external deficit of about $400 billion per year continues to drain about 2 million jobs from the economy. Trade appears to offer one of the few avenues for accelerating US growth and creating good jobs.

President Obama set a goal of doubling US exports over the five-year period to 2014. That target will be badly missed despite being based on a year (2009) when the Great Recession temporarily depressed foreign sales. The administration is now seeking to promote exports through its major trade negotiations, the TPP and TTIP. A CHUSTIA would be very much in the spirit of that strategy and, as chapter 2 shows, would generate considerably larger export expansion for the United States than even a TPP that included the 16 countries that seem likely to join the agreement after a second round of negotiations. As described above, a CHUSTIA accompanied by rebalancing of the two economies would be even better.

Both China and the United States could derive major benefits from increased trade and investment. There are several paths forward: multilateral liberalization in the WTO through a revived Doha Round or some wholly new initiative; plurilateral sectoral deals such as TiSA and ITA2; regional arrangements such as RCEP, the TPP, or possibly an FTAAP and TTIP; bilateral negotiations with each other or other countries; or unilateral action, as China has done on numerous occasions in the past. These paths are mutually reinforcing, with successful "competitive liberalization" initiatives often proceeding simultaneously (Bergsten 1996). There can even be direct linkages among the paths: partners in a bilateral negotiation could agree to work together in broader regional and multilateral forums to advance some of their bilateral goals. The United States often has insisted that its partners in bilateral talks support its initiatives in broader groupings. This study addresses primarily the bilateral CHUSTIA alternative but also looks at alternative mechanisms through which the functional equivalent might be achieved, such as through Chinese accession to the TPP, fusion between the TPP and RCEP, or perhaps an FTAAP. It embeds the analysis in the broader trade architecture that now exists and is being built in so many directions, to ask what a CHUSTIA could add and what economic and political difficulties it will face.

What Might a CHUSTIA Contain?

If Chinese and US authorities decide to pursue an FTA, two major sets of questions arise. First, what might be the substantive content of such an agreement? Second, what negotiating modalities might the countries pursue, accounting for the other trade agreements in which they are involved and the broader political context in which they would be operating? We offer a range of options to help promote thoughtful discussion in both countries and to provide possible points of departure when the time comes to make decisions.

We are also fully aware of the gravity, and political sensitivity in both countries, of any decision to launch a CHUSTIA initiative. We therefore want to offer alternatives for proceeding incrementally, perhaps starting the process through separate agreements on one or two of the fifteen topics that we address as possible elements of an eventually comprehensive FTA. We structure our discussion of some of the issues as pointing toward either a single chapter of an overall compact or, more modestly and perhaps more immediately, a stand-alone arrangement that would be largely self-balancing and thus make sense on its own whether or not it is integrated into something broader over time. China and the United States might pursue some issues within the framework of a broader plurilateral agreement, such as the GPA in the WTO. The basic concept is to think of these individual topics, and efforts to reach accommodation on them, as possible stepping stones or building blocks toward something larger, but also as items worth addressing in and of themselves even if nothing more extensive eventuates. Successful negotiations on individual topics could generate positive momentum toward a broader compact and help overcome the mistrust that threatens the relationship between the two countries.

The current China–US BIT negotiation is a case in point. Our analysis suggests that FDI in both directions, especially from China into the United States, could expand rapidly in the coming years. The potential gains from a sizable expansion of such activity could add significantly to the economic payoff from a CHUSTIA. The countries have agreed that investment between them is a priority topic and now seek to negotiate a BIT that would improve the investment climate in both nations. Chapter 13 in this study suggests several possible areas of agreement that range beyond what is currently contemplated for the BIT.

As for the substance of a possible CHUSTIA, we analyze fifteen discrete topics that could be considered for inclusion. Our list draws on the record of previous FTAs by both countries plus, in three cases, issues about which China, the United States, or both have expressed strong concerns: export controls, currency and rebalancing, and cyberespionage. An initial phase of the process would undoubtedly determine which items from this list could be placed on the agenda for negotiations, whether comprehensive or issue by issue. We offer our own suggestions in the concluding chapter of this study after assessing each topic in the chapters that follow.

Each chapter summarizes General Agreement on Tariffs and Trade (GATT) and WTO provisions that address the topic in question, even if tangentially. We then search for further guidance in existing US and Chinese FTAs, which will presumably be augmented when the TPP, the pending China–Korea FTA and China–Australia FTA, and eventually the RCEP are concluded. The individual chapters emphasize differences between the US and Chinese positions. At this early juncture, it is useful to illuminate potential sticking points to provide a realistic view of the landscape ahead.

It would be more feasible politically, and perhaps more desirable substantively, to pursue an incremental approach in sectors that offer opportunities for a high degree of reciprocity within their individual confines. This is the theory behind the BIT negotiations, in which each country has a keen interest in enhancing access and strengthening protections for its investments in the other. Another possibility might be government procurement, in which each country seeks increased ability to participate in the large infrastructure projects of the other—including at the subfederal level through the states of the United States and the provinces in China. We first discuss the issues that might be susceptible to stand-alone agreements.

Some of the sectors under consideration are unbalanced in the direction of requests by one of the potential partner countries. The US desire to tighten China's IPR enforcement far outweighs any reciprocal Chinese interest in such US enforcement. China's hope to achieve access to energy supplies from the United States has no US parallel. Significant liberalization in these areas would presumably have to be part of a broader deal encompassing tradeoffs across topics. We address this cluster of topics together.

In essence, we distinguish between sectors that are potentially susceptible to intrasectoral reciprocity or only to intersectoral reciprocity. Liberalization could presumably proceed on a stand-alone basis more easily on intrasectoral topics. Intersectoral candidates would probably need to be part of a broader package. We are mindful of this criterion in assessing the prospects for each sector and where it might fit into the overall picture for a trade agreement between China and the United States.

A third group of issues may be better addressed through parallel agreements, perhaps in a broader multilateral context, rather than inclusion in a CHUSTIA or even in separate bilateral accords. The most obvious candidates are cyberespionage and currency. We discuss these in a separate cluster while acknowledging that they may have to be included in a CHUSTIA if alternative arrangements cannot be agreed on a timely basis.

How Might a CHUSTIA Proceed?

We envisage that China–US economic talks, whether aiming for a comprehensive FTA, a selective sector-by-sector approach, or something in between, could proceed under either of two broad mandates from their governments. The more ambitious would be for Chinese and US leaders, after going through the appropriate domestic procedures, to publicly set a goal of achieving a comprehensive FTA and direct their negotiators to pursue that goal. They could also set a firm deadline, as the United States has done de facto in the past through the expiration dates of the Trade Promotion Authority granted by Congress,[7] or leave that issue open to see how the talks proceed, as with all current negotiations. The more incremental strategy would be for the leaders to direct their teams to start negotiating on specific issues: one or more, specified from the outset or left to be determined later, explicitly viewed as one-off agreements, linked to the future evolution of something broader, or with that critical decision simply left open.

There are three basic options on the international side. The most straightforward is a bilateral negotiation like those that the two countries have already conducted with numerous trade partners. This would have the virtues of simplicity and familiarity. It might be the most appropriate technique for the two largest economies in the world in pursuing such a historic and potentially pathbreaking arrangement. As a bilateral initiative, it would potentially have the most far-reaching effects on relations between the two countries.

An alternative is to embed a China–US FTA in a broader compact that includes a number of other countries in the region. China could join the TPP, in which it has shown increasing interest. As the current negotiations for the RCEP and TPP essentially represent a two-track process toward liberalizing trade in Asia and the Pacific, the two agreements could merge at a later stage. As China will be a charter member of the RCEP and the United States a charter member of the TPP, any such integration would represent at least a step toward

7. The Korea–US FTA, for example, was agreed literally within ten minutes of the expiration of US fast track authority (TPA) in 2007.

freer trade—defined by whatever hybrid emerged from an RCEP-TPP negotiation—between those two countries. A third possibility, which China mentioned in APEC meetings in early 2014, is to move directly toward an FTAAP with the TPP and its presumably higher standards (and perhaps RCEP) remaining intact in addition.

Achieving free trade or significant liberalization between two major economies indirectly has at least two precedents. About one-half of the economic effect of the TPP will be freer trade between the United States and Japan (chapter 2, table 2.12). In a much earlier period, the two-track liberalization of trade in postwar Europe by the original Common Market (led by France and Germany) and the European Free Trade Association (led by the United Kingdom) essentially merged into the European Community and then the European Union.

The choice between methods[8] will presumably turn on Chinese and US assessments of the economics and politics of the issues at the time. The criticism in the United States of achieving freer trade with Japan through the TPP has been very modest compared with the extensive Japan-bashing and fear of Japanese dominance in the 1980s. There might be less risk of failure for a China–US initiative—which would have major negative repercussions on their overall relationship—from pursuing an indirect route rather than the direct bilateral path. In addition, the effects of the two different paths would be quite different for a number of other countries in the region. Non-TPP members, such as Indonesia and Thailand, would not obtain increased access to the United States after a CHUSTIA unless they negotiated their own FTAs with the United States or joined a TPP without China's doing so. Non-RCEP members, such as Canada and Mexico, would have to negotiate their own FTAs with China to get increased access to its market. These countries will presumably try to influence the decisions of the two superpowers in the direction of merging the TPP and RCEP into an FTAAP rather than pursuing their own bilateral agreement.

Interim Steps

Whether and how China and the United States decide to pursue intensified economic cooperation, their decisions on the matter are presumably some time away. In the interim, and before they are in a position to set a firm course of action, they might initiate informal consultations through which they could share views on their current regional negotiations and trade policies

8. Another possibility is of course multilateral liberalization in the WTO, whether through a renamed Doha Round or a wholly new initiative. All previous WTO or GATT rounds have only pursued modest reductions in trade impediments, however, so this approach would be highly unlikely to produce free trade between China and the United States. We nevertheless consider several multilateral—or at least plurilateral—possibilities, such as the TiSA for services and ITA2 for high-technology products, where the ambition of the participants appears to be sufficiently high to posit the possibility of substantial liberalization.

more broadly, getting a better sense of what the potential partner is thinking. Kissinger (2013, 180) suggests that the two countries begin any of their cooperative efforts "with a common analysis of where we think the international system is going and should go."

Such conversations could proceed bilaterally, perhaps through the Strategic and Economic Dialogue. If that would raise concerns about the reactions of other countries, or domestic anxieties within either country, they could proceed in a regional forum such as APEC, which has been sponsoring discussions of existing bilateral FTAs and their implications for its long-term Bogor Goal of achieving "free and open trade and investment in the Asia-Pacific region."[9] Unofficial conversations can be carried out through the variety of track II dialogues between the two countries. The US–China CEO and Former Senior Officials' Dialogue, conducted by the US Chamber of Commerce and the China Center for International Economic Exchange, have addressed these issues most directly and positively to date.

Another timing issue could prove to be important. Both countries currently have very active negotiating agendas, the United States with the TPP and TTIP, and China with Korea, Australia, and the RCEP. Some observers believe the two countries would be hard pressed to take on major new trade initiatives in the near future. Yet the demonstrated dynamic of competitive liberalization suggests that excluded partners may be eager to close incipient gaps in their trade patterns sooner rather than later, or even head them off, implying that it might be better to strike while the iron is hot. No definitive judgment is possible at this point, but these timing considerations should be kept in mind in considering a strategy for how to proceed.

This volume turns now to detailed analyses of each of the key issues that will be central to any decision to launch a new trade initiative between China and the United States. In chapter 2, Peter A. Petri, Michael G. Plummer, and Fan Zhai assess the prospects in the coming decade for overall trade between the two countries and their global trade positions, both on their current policies and whether they significantly liberalize trade between them. They examine the economic effects of an FTA on other major parts of the region and the world as well as on China and the United States themselves, with substantial sectoral disaggregation to show how an agreement might work in practice. They assess the interaction between a possible CHUSTIA and the macroeconomic rebalancing processes that are currently under way and will presumably continue. Finally, the chapter provides a systematic comparison of alternative routes to China–US free trade and a cumulative assessment of the potential interactions among a CHUSTIA, the TPP, the RCEP, and an FTAAP.

Chapter 3, by Robert Z. Lawrence, addresses the adjustment challenges that a CHUSTIA would pose for the United States. It reviews several prominent analyses of the effects over the past two decades of China–US trade, especially on employment and manufacturing wages, and the relevance of those studies

9. Bogor Declaration in 1994, www.apec.org (accessed on July 17, 2014).

to the prospects of a move to relatively free trade and investment between the two countries. It then offers several proposals for US policy responses to those adjustment challenges.

The remainder of the chapters except the last address each of the specific topics that might be covered in a comprehensive negotiation, in parallel compacts, or as stand-alone components that could become building blocks for a broader agreement. The final chapter then draws together all these elements to reach conclusions on the merits of the idea and how the two governments might proceed.

Before turning to these topics, however, we briefly detour to a recent case of extensive trade liberalization between the United States and another major Asian country. We do so because we believe it is relevant for considering the prospects for a CHUSTIA and because it offers a more optimistic perspective for viewing the possibility of a pathbreaking agreement than can be found in either country at this time.

Postscript: The Path to a Korea–US FTA (KORUS)

In 2000 Han Duk-soo, then Korea's minister of trade, later to become prime minister and ambassador to the United States, asked the Institute for International Economics (as PIIE was then called) to prepare an initial study of a possible FTA between his country and the United States. Minister Han readily acknowledged that there was no active discussion of the issue in Korea, which was the case in the United States as well. He further noted that, to the extent the idea had been considered at all, there was great hostility to it in the Korean agricultural community and widespread opposition from business.

Minister Han had a vision, however, that a KORUS, as it came to be called later, was an idea whose time might come. He believed that the way to start a discussion was to conduct a thorough analysis to see whether the concept made sense and what the main hurdles might be to pursuing it. If the results were positive, others might be stimulated to address the issue and it might enter the policy discourse in both countries.

The Institute regarded such a topic as an ideal addition to its research agenda as it offered an opportunity for precisely the kind of thought leadership that a think tank should provide. This was especially true on the proposed topic, as Institute researchers had previously done some of the pioneering studies of earlier US FTAs, with Canada and then with Mexico through NAFTA. The Institute expert on trade negotiations, senior fellow Jeffrey J. Schott, immediately agreed to take on the project and persuaded Inbom Choi, a trade economist with experience in Korean think tanks and a former high government official, to join the research team to provide an equal Korean perspective.

The authors completed their study with all deliberate speed and the Institute released the results in April 2001 (Choi and Schott 2001). It soon became the subject of seminars and conferences in both countries, including some at the Institute, and began to enter the policy discussion. At one of these events in 2003, most of the Korean participants continued to express skepticism as to whether their government could ever overcome domestic political opposition to the idea, especially from agriculture, but others asked whether the payoff from an FTA with the United States might be great enough to permit a breakthrough. At another Institute event in 2004, US Trade Representative Robert Zoellick indicated, for the first time in public, that he could contemplate adding Korea to the growing list of countries with which he was negotiating FTAs whenever Korea indicated that it was ready to seriously include agriculture in such talks. Meanwhile Trade Minister Kim Hyun-chong in Korea was exercising remarkable leadership in forging a brilliant strategy of multiple FTAs for his country and launching complementary domestic policies, especially regarding agriculture, that enabled them to eventually command the necessary support in Korea's national assembly.

Informal prenegotiations for KORUS took place in 2004 and 2005 and formal negotiations began in 2006. Final agreement was reached in 2007, literally at the very hour that the existing Trade Promotion Authority for the US government—which has yet to be renewed—was expiring. The outgoing Bush administration could not submit the new agreement, or similar agreements with Colombia and Panama, for congressional approval because the new Democratic majority in the House of Representatives was unreceptive. But the Obama administration was finally able to do so, after a substantial delay and minor modifications of the agreement, and won ratification of KORUS in 2011.

KORUS entered into force in March 2012 and now stands as the most important FTA that the United States has ever negotiated in Asia, perhaps anywhere. For Korea, it is clearly the most important FTA it has signed, along with its agreement with the European Union. It took 12 years for Minister Han Duk-soo's idea to become reality. It began with a study that the Institute undertook at a time when there was literally no interest in, and even considerable opposition toward, the entire concept. Patience was needed, but was finally rewarded, and the wait was well worth it.

A similar evolution could conceivably occur regarding the idea of a China–US FTA. Such a pact would clearly be the most important in which either party has ever participated. There is now very little discussion of the idea in either country, and to the extent that there is, at least in the United States, the majority of opinion is negative; there is reluctance to contemplate Chinese membership in the TPP let alone a bilateral pact with the United States. Strong leadership would be needed in both countries to convert this skepticism into support.

At least one far-sighted and highly influential person in each country, however, has had a vision of a China–US FTA as a way to deal with the countries' ongoing trade frictions and place their overall relationship on a stronger footing. Maurice R. ("Hank") Greenberg—former chairman of American International Group, now chairman and CEO of C.V. Starr and Company, and one of the most experienced and highly respected US business leaders regarding China—originated the discussion in 2009 while noting that the idea "would take ten years to work out." It was later picked up by the China–US Exchange Foundation and its chairman, C. H. Tung, the first chief executive of Hong Kong and now vice chairman of the Standing Committee of the Chinese People's Political Consultative Conference. The foundation's report, *US–China Economic Relations in the Next Ten Years: Towards Deeper Engagement and Mutual Benefit,* in early 2013 called for serious think tank study of the idea over the coming year and for the two governments to institute a process toward negotiations on it if the study produced positive conclusions. The US Chamber of Commerce and the China Center on International Economic Exchange then promoted the project; in 2011 they together instituted a track II US–China CEO and Former Senior Officials' Dialogue to discuss economic relations between the two countries.

This study attempts to fulfill the first part of the mandate from the 2013 report with the hope that, as in the case of KORUS, it will lead to serious consideration of the idea of a China–US FTA in both countries and perhaps eventual policy initiatives. A CHUSTIA would be even more significant than KORUS, in both partner countries and the world as a whole, with stakes that are enormous and a payoff that could be far greater. The analysis that follows, and the conclusions and recommendations that are offered at the end, seek to spark active debate on an idea whose time might be coming.

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