

***Bridging the Pacific:***  
**Toward Free Trade and Investment Between  
China and the United States**

**October 16, 2014**

**C. Fred Bergsten, Gary Hufbauer, Sean Miner**

# Export Gains Under Alternative FTAs, 2025

|                                     | GDP 2025     | Export gains (billions of 2007\$) |       |       |       |       |
|-------------------------------------|--------------|-----------------------------------|-------|-------|-------|-------|
| Economy                             | (Bil 2007\$) | TPP-16                            | RCEP  | CHUST | All   | FTAAP |
| <b>Current TPP Countries</b>        |              |                                   |       |       |       |       |
| Australia                           | 332          | 16                                | 43    | -2    | 48    | 59    |
| Canada                              | 597          | 18                                | -2    | -14   | 2     | 34    |
| Chile                               | 151          | 5                                 | -1    | -1    | 2     | 9     |
| Japan                               | 1,252        | 203                               | 225   | -16   | 357   | 419   |
| Mexico                              | 507          | 40                                | -1    | -15   | 22    | 102   |
| Peru                                | 95           | 7                                 | 0     | -1    | 6     | 11    |
| United States                       | 2,813        | 191                               | -4    | 373   | 519   | 626   |
| Vietnam                             | 239          | 92                                | 30    | -6    | 95    | 139   |
| <b>Potential Future TPP Members</b> |              |                                   |       |       |       |       |
| China                               | 4,597        | -108                              | 638   | 472   | 982   | 1,590 |
| Indonesia                           | 501          | 98                                | 53    | -7    | 112   | 119   |
| Korea                               | 718          | 95                                | 174   | -17   | 206   | 244   |
| Thailand                            | 476          | 83                                | 35    | -10   | 83    | 75    |
| <b>Other Countries</b>              |              |                                   |       |       |       |       |
| Europe                              | 7,431        | -76                               | -42   | -66   | -158  | -329  |
| India                               | 869          | -13                               | 238   | -12   | 211   | 536   |
| Rest of world                       | 4,955        | -59                               | -26   | -48   | -115  | -240  |
| <b>Memorandum</b>                   |              |                                   |       |       |       |       |
| TPP-16                              | 8,512        | 942                               | 579   | 266   | 1,539 | 1,924 |
| RCEP                                | 10,795       | 538                               | 1,466 | 369   | 2,155 | 3,500 |
| APEC                                | 15,126       | 804                               | 1,211 | 716   | 2,475 | 4,073 |

# CHUSTIA's Potential Economic Effects

|  | United States                         | China                                 |
|--|---------------------------------------|---------------------------------------|
| Income gains (annually by 2025)                                | \$130 billion<br>(0.6 percent of GDP) | \$330 billion<br>(1.9 percent of GDP) |
| Productivity gains   | 0.8 percent                           | 1.9 percent                           |
| Annual gains in manufacturing exports (by 2025, over baseline) | 12 percent                            | 10 percent                            |
| Annual gains in service exports                                | 18 percent                            | 2 percent                             |
| Annual gains in agriculture exports                            | 13 percent                            | -2 percent                            |
| US export increase to China, 2015 to 2025                      | 108 percent                           |                                       |
| Chinese export increase to US, 2015 to 2025                    |                                       | 40 percent                            |

# US Adjustment Costs and Responses

- Annual separations of 50-100,000 workers for 10 years. Total separations of workers over 10 years represent maximum of 0.8 percent of US employment.
- Policy proposals:
  - Lengthy phase-ins of liberalization of sensitive sectors.
  - Ramp up Trade Adjustment Assistance.
  - Provide much larger wage-loss insurance and training and relocation benefits.
  - Endorse Obama proposal for consolidating all worker training programs.
- National economic benefits will reach \$1.25 million in 2025 annually for each involuntarily separated worker.

## 3 Modes of Closer Cooperation

1. **CHUSTIA** – Comprehensive Bilateral China-US Trade and Investment Agreement
  
2. **Step-by-Step Route to CHUSTIA**
  - Bilateral Investment Treaty (BIT)
  - Information Technology Agreement 2 (ITA2)
  - Government Procurement Agreement (GPA)
  - Trade in Services Agreement (TISA)
  - Environmental Goods Agreement (EG)
  - Stand-alone Bilateral Agreements on Tariffs and possibly Agriculture, Government Procurement
  
3. **Trans-Pacific Partnership (TPP)** or TPP and Regional Comprehensive Economic Partnership (RCEP) Leading to Free Trade Area of Asia Pacific (FTAAP)

# Income Gains Under Alternative FTAs, 2025

| Economy                             | GDP 2025     | Income gains (billions of 2007\$) |      |        |           |       |
|-------------------------------------|--------------|-----------------------------------|------|--------|-----------|-------|
|                                     | (Bil 2007\$) | TPP-16                            | RCEP | CHUSTI | All three | FTAAP |
| <b>Current TPP Countries</b>        |              |                                   |      |        |           |       |
| Australia                           | 1,433        | 7                                 | 17   | 0      | 22        | 24    |
| Canada                              | 1,978        | 9                                 | 0    | -4     | 4         | 22    |
| Chile                               | 292          | 3                                 | 0    | 0      | 3         | 7     |
| Japan                               | 5,338        | 84                                | 76   | -5     | 136       | 157   |
| Mexico                              | 2,004        | 31                                | 3    | -5     | 26        | 73    |
| Peru                                | 320          | 5                                 | 0    | 0      | 4         | 6     |
| United States                       | 20,273       | 68                                | 0    | 130    | 191       | 202   |
| Vietnam                             | 340          | 47                                | 17   | -3     | 53        | 74    |
| <b>Potential Future TPP Members</b> |              |                                   |      |        |           |       |
| China                               | 17,249       | -82                               | 211  | 330    | 454       | 582   |
| Indonesia                           | 1,549        | 54                                | 17   | -3     | 50        | 37    |
| Korea                               | 2,117        | 43                                | 71   | -5     | 91        | 113   |
| Thailand                            | 558          | 42                                | 15   | -3     | 41        | 28    |
| <b>Other Countries</b>              |              |                                   |      |        |           |       |
| Europe                              | 22,714       | -5                                | 5    | -1     | 0         | -36   |
| India                               | 5,233        | -7                                | 87   | -6     | 73        | 214   |
| Rest of world                       | 16,241       | -16                               | -7   | -11    | -30       | -79   |
| <b>Memorandum</b>                   |              |                                   |      |        |           |       |
| TPP-16                              | 38,016       | 455                               | 239  | 96     | 691       | 814   |
| RCEP                                | 36,535       | 249                               | 535  | 300    | 990       | 1,303 |
| APEC                                | 58,951       | 17                                | 458  | 422    | 1,143     | 1,768 |

# Effects of CHUSTIA on trade, 2025

|                   | China                |          | United States        |          |
|-------------------|----------------------|----------|----------------------|----------|
|                   | Baseline<br>(\$bill) | % change | Baseline<br>(\$bill) | % change |
| Global exports    | 4,597                | 10.3     | 2,813                | 13.3     |
| Global imports    | 4,253                | 10.9     | 3,577                | 10.8     |
| Bilateral exports | 1,121                | 41.2     | 447                  | 108.9    |

# Barriers to China-US trade and Investment

|                 | Barriers 2010 |               | After CHUSTIA |               |
|-----------------|---------------|---------------|---------------|---------------|
|                 | China         | United States | China         | United States |
| Tariffs (%)     |               |               |               |               |
| Agriculture     | 3.2           | 1.5           | 1.2           | 0.6           |
| Non-agriculture | 4.6           | 3.0           | 1.7           | 1.1           |
| NTBs (% AVE)    |               |               |               |               |
| Agriculture     | 33.4          | 11.0          | 18.4          | 6.1           |
| Non-agriculture | 16.7          | 3.7           | 9.2           | 2.0           |
| Services        | 76.5          | 3.9           | 45.8          | 2.3           |



# Difficult China-US Issues

- Intellectual property rights
- Competition policy
- State-owned enterprises
- Labor rights
- Services liberalization
- Trade imbalances and exchange rates
- Cyber espionage

# US Service Exports

- US has a strong comparative advantage in exporting business services.
- Baseline forecast: US will export \$928 billion worth of services in 2025, CHUSTIA will increase that by 18 percent (to \$1095 billion).
- US outward FDI stock in services accounted for 73 percent of FDI stock in 2012 (\$3.3 trillion out of \$4.5 trillion).

# Projected US Service Exports to China

|                                   | Baseline (2025)<br>(\$billions) | Increase from<br>CHUSTIA (\$billions) | Projected Total<br>(2025) (\$billions) |
|-----------------------------------|---------------------------------|---------------------------------------|--|
| Total                             | 126                             | 218                                   | 344                                    |
| Banking                           | 10                              | 28                                    | 38                                     |
| Transportation                    | 12                              | 30                                    | 41                                     |
| Computer/IT                       | 2                               | 5                                     | 7                                      |
| Royalties/licenses                | 20                              | 45                                    | 65                                     |
| Professional<br>Business Services | 5                               | 50                                    | 55                                     |
| Education                         | 24                              | 8                                     | 32                                     |
| Travel                            | 52                              | 42                                    | 94                                     |
| Communications                    | 1                               | 5                                     | 6                                      |

# Chinese Service Barriers

- China's barriers to services trade are high (World Bank and OECD metrics).
- China's FTAs with Chile and Costa Rica are ambitious for services, but they don't match US FTAs.
- China historically negotiated service barriers on a "positive list" basis. China-Canada BIT is an exception.
- Cross-border service trade is still restricted in many areas: digital, legal, finance.
- FDI in services is highly restricted.

# Financial Services

- Foreign bank market share in China is only 2 percent due to heavy barriers.
- Foreign banks in China must hold more than \$10 billion in assets, have a representative office for over two years before establishing a branch, and can only accept deposits larger than 1 million RMB.
- Cross-border electronic trade in financial services is severely limited.

# Foreign Direct Investment

- Bilateral investment is abnormally low.
- US has around \$50 billion FDI stock in China, around 2 percent of total.
- China's stock in the US is around \$36 billion, around 1 percent of the total.
- By 2020, China's stock in the US could reach \$122 billion. And US FDI stock in China could reach \$160 billion.

# FDI - Continued

- US FDI in China is concentrated in manufacturing (60 percent), with 20 percent in services. By contrast, US FDI with world is 73 percent in services.
- China's FDI in the US is concentrated in energy, manufacturing, and foodstuffs. Infrastructure could be big in the future.

# US Barriers to FDI from China

- National security restrictions, limiting investment in certain sectors: transportation, communications, and natural resources.
- Discretionary barriers, notably political objections to mergers & acquisitions.
- China wants CFIUS to apply the same criteria to Chinese firms as to British firms.



# Chinese Barriers to US FDI

- Domestic firms receive favorable tax treatment and financing, as well as favorable government procurement.
- Long list of restricted and prohibited sectors for investment. Many areas are limited to less than 50% foreign ownership.
- China's discriminatory application of its Anti-Monopoly Law worries foreign firms (Chamber of Commerce report).
- Complicated and opaque approval process for FDI.

# China-US Bilateral Investment Treaty

## Background:

- US has 41 BITs, none are based on 2012 US Model BIT.
- China has 104 BITs: ratified with Canada in 2014, Switzerland in 2009, Mexico in 2008. Currently negotiating with EU and US.
- China-US BIT talks started in 2008; 14<sup>th</sup> round held in July 2014.

# Sticking Points in China-US BIT

- Chinese pressure to use local technology and idiosyncratic standards.
- Low Chinese foreign ownership limits.
- Lengthy negative list of closed sectors.
- Absence of pre-establishment rights.
- Opaque national security reviews.
- BIT would require 2/3 Senate vote and several BITs are NOW backed up on Hill.

# US Goals in a BIT

- Spell out exactly which industries are not open for investment, --a short “negative list.”
- Clear pre-establishment rights for permitted investments; shorten bureaucratic reviews.
- Bring China closer to a “one-stop shop” by consolidating review functions in the NDRC.
- Control discriminatory use of Anti-Monopoly Law.
- Clarify US and Chinese national security review processes.

# China's State-Owned Enterprises

- SOEs have near total control of telecoms, oil and gas, and finance, plus major control in other sectors.
- State-Owned Assets Supervision and Administration Commission (SASAC), China's State Council, oversees over 100 of China's largest SOEs, and picks their leaders.

# US wish list for SOEs

- Transparency in financial statements
- Disclosure of preferential treatment, subsidies, and offsetting costs (provision of public services).
- Effective competition rules on SOEs.
- Justification when SOEs promote their industrial policy objectives in competition reviews of inward FDI.
- SOEs should make decisions based only on commercial considerations, free from government influence.
- Procedures to ensure that SOEs treat foreign imports the same as domestic goods for procurement.

# Dispute Settlement

- A strong mechanism for dispute settlement is essential.
- Between 2002 and 2013, China and the US were involved in 24 cases against each other in the WTO's dispute settlement body.
- CHUSTIA should create its own arbitration system for subjects not covered by the WTO.
- Investor-state dispute settlement system, via the World Bank's International Center for the Settlement of Investment Disputes (ICSID) is essential.