RETHINKING THE RISE AND FALL OF THE TPP
Why the Analysis of Trade Agreements Requires an Overhaul

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Note for Cambridge Trade & Brexit Mini-Conference Participants:

The following piece draws from two different draft articles intended primarily for non-economists. Please keep this in mind, especially since the language and style differs from the standard convention in economics. Despite this difference, I hope that my findings will prove interesting and of relevance to you.

I use the TPP as a case study to draw attention to problems in how we analyze contemporary trade agreements, and in particular, on the issue of trade diversion for non-parties to bilateral/regional trade agreements.

I am most interested in your thoughts and feedback concerning:

- Are my methodological critiques of the CGE models employed accurate? If so, have there been efforts undertaken (or which are ongoing) to correct for the shortcomings of CGE models, with which I may not be familiar?

- What do you think of the methodological approach taken to address existing shortcomings in analyzing trade diversion?

- Are there may be further efforts being taken in economics to address the impact of rules-of-origin for trade agreements beyond what is discussed?

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INTRODUCTION

Arguably the most important global economic phenomenon of the past quarter-century has been the increasing fragmentation of production and the rise of global value chains. Accompanying this phenomenon is a growing demand for trade agreements. As the World Trade Organization (WTO) multilateral negotiations have stalled, these new treaties increasingly take the form of bilateral or regional trade agreements (RTA). In 2017, the WTO reported 445 notifications of regional trade agreements – a dramatic rise from only 124 in 1994.[1]

Not only has the number of trade agreements increased dramatically but so too has their legal complexity. The earliest trade agreements dealt primarily with tariffs in goods. However, contemporary trade agreements address a much wider spate of issues. These range from services, intellectual property, and trade remedies to investment, e-commerce, and competition. In short, they cover the broad set of behind-the-border regulatory issues that impact global value chains.

As trade agreements encompass a broader scope, not surprisingly, their size has ballooned. The Trans-Pacific Partnership (TPP), a mega-RTA negotiated between twelve countries in the Asia-Pacific, totaled more than 5,000 pages of treaty text and schedules. Nor was the TPP a special case simply because it involved so many countries of varying degrees of economic development. The Comprehensive Economic and Trade Agreement (CETA), concluded in 2016 between two advanced economies, the European Union and Canada, amounted to more than 1,600 pages of text.[2] No longer is it the case that a trade agreement can be easily understood by an outsider without specialized knowledge of trade law.

While the scope, scale, and legal complexity of trade agreements have increased dramatically in the past two decades, the analytical tools used to assess trade agreements have not kept pace. Trade policymakers still rely on largely the same set of analytical tools as they did decades ago. These are tools developed for an earlier generation of trade agreements, when production was nowhere close to as fragmented and agreements, therefore, not as complex. Moreover, the analytical tools remain grounded largely in economics; the most influential studies tend not to draw on a cross-disciplinary approach.

This proves problematic. At a time when contentious debates are raging worldwide over trade, policymakers are being presented with incomplete – and therefore, possibly inaccurate – information assessing the impact of trade agreements. The models for assessing trade are increasingly disconnected from the realities of trade. While academics regularly employ a range of cross-disciplinary tools to assess specific trade

[1] World Trade Organization, Regional Trade Agreements: Facts and Figures, https://www.wto.org/english/tratop_e/region_e/regfac_e.htm (last visited Sept. 17, 2017).

[2] Rev. Ben Johnson, *What is the Comprehensive Economic and Trade Agreement (CETA)?*, ACTON INSTITUTE POWERBLOG, Feb. 20, 2017.

litigation cases, they are not necessarily doing the equivalent for specific trade agreements.

Within legal academia, however, this problem has merited little attention. Even though trade agreements are increasingly about complex legal rules and less about tariffs, legal academics have tended to cede the task of analyzing the overall impact of a specific trade agreement to economists. Instead, legal academics, in recent years, have tended to focus on other problems associated with trade agreements. They include procedural issues (*e.g.*, the lack of transparency), facets of the agreement that reshape the balance of legal rights (*e.g.*, investor-state dispute settlement), and provisions extending legal rules that some deem problematic (*e.g.*, intellectual property protections).

Outside of law, the problems may be better known, but they too have not garnered as much concern as one might expect. When it comes to updating models and reforming analytical approaches, economists and political scientists have also fixed their attention elsewhere. This includes modeling firm-level behavior, building uncertainty into the models, and better explaining individual behavior taken in response to trade policies. So far as I am aware, despite the massive changes over the past quarter-century in the economic forces underlying trade, there has not been a clarion call to overhaul the models or analytical approach used to assess contemporary trade deals.

To be clear, the problem with which I seek to draw attention is not one of theory, but of *applied* analysis. At a theoretical level, important inter-disciplinary work has been taking place on the evolving forms of trade agreements. These include the rise of WTO plurilateral agreements[3] and the shift toward trade-in-services agreements.[4] But at the applied level, when it comes to actually analysis of the gains and losses from specific trade agreements, similar work has not taken place. While our theoretical understanding of how 21st Century trade agreements are different may be improving, the tools used to analyze such agreements are not. Yet, the latter plays a critical function in contemporary debates over the future of trade agreements.

The overall manner in which we analyze specific trade agreements is in dire need of a revamp. Specifically, existing tools need to better reflect the realities of 21st Century trade, one in which production is configured along global value chains and has shifted increasingly toward China. This Article uses the rise and fall of the TPP to highlight two particular problems with how we analyze the impact of trade agreements today. For each problem, I first highlight issues with the existing approach, before proposing potential ways to improve the analyses.

First, as trade negotiations shift from multilateral to bilateral / regional deals, a key question that arises is the impact of these agreements not only on those countries

[3] *See, e.g.*, Bernard Hoekman & Petros Mavroidis, *WTO 'A la Carte' or Menu du Jour'? Assessing the Case for More Plurilateral Agreements*, 26 EURO. J. INT'L L.319 (2015).

[4] *See, e.g.*, Robert Staiger & Alan Sykes, *The Economic Structure of International Trade-in-Services Agreements* (working paper).

partaking in the agreement, but also those excluded from it. I contend that the prevailing model used to analyze questions of trade diversion fail to reflect the realities of 21st Century fragmented production in which trade is often structured along global value chains. Consequently, their results are increasingly imprecise. Until economists are able to fix this problem, additional analyses, oriented around a partial rather than general equilibrium model, are required cross-check the results and ensure that policymaking is not led astray.

Second, with recent shifts in the nature of production, the focal point of trade negotiations has become less about tariffs and more about the rules of origin (ROOs) as legally crafted within the trade agreement. However, the existing analytical approach still tilts heavily toward examining tariff-related impacts, without due regard to the growing importance of ROOs. This shortcoming is leading to imprecise and inaccurate assessments of the impact of trade agreements at a sectoral level. More detailed analyses of the legal rules as well as the intra-sector dynamics of trade are required to address this problem.

Third, the disaggregation of production have also led to a shift in the relative geopolitical power of the major state actors within the trade regime. Most dramatic has been the re-emergence of China since its accession to the WTO in 2001 and its increasing clout within the international economic order. While the impact of China's rise has received much attention in the academic literature, scholars have devoted much less attention to the question of how the internal dynamics of trade policymaking may differ in these rising powers and how they are evolving. Consequently, the political economy analysis of trade policymaking for rising powers, especially China, is also incomplete. This represents yet a third area where updating is required.

Correcting these analytical shortcomings is important not only for the sake of improving scholarship, but also for policymaking. The stakes are large, as trade officials, in developed and developing countries alike, debate how to press forward on trade agreements given growing domestic populist opposition. Developing an accurate understanding of the facts and frameworks is critical to ensuring a meaningful public discourse.

I. THE CASE FOR THE TRANS-PACIFIC PARTNERSHIP

When it comes to understanding the impact of regional trade agreements, the questions with which scholars and policymakers grapple are still largely the same as they were a generation ago. Who gains and who loses from the trade agreement? How much trade will be created versus how much will be diverted? What impact will it have on the trade policies and negotiating positions of those excluded from the agreement? Ultimately, will the agreement serve as a building block for future multilateral rules or as a stumbling block that fragments the system?

Although the overarching questions remain similar, the underlying dynamics of trade are starkly different in the early 21st Century than they were just a few decades

ago. Global economic production is being dramatically transformed, thanks to advances in technology. This, in turn, has produced massive shifts in the patterns of global trade and re-oriented the strategic considerations of policymakers as they seek to make trade work for their national advantage. Consequently, the nature of the legal commitments found within trade agreements has evolved dramatically over the past fifteen years. Finally, as global production and trade patterns have shifted, so too has the configuration of major players in shaping the trade regime and their focal points of interest.

Despite these changes, however, the strategic rationale for regional trade agreements remains largely the same as it was in the 1980s. Consider the case of the TPP.

A. Updating Rules and Countering a Rising China

Advanced economies have sought to update trade rules to reflect these new realities. After failing initially in 1999, the WTO announced the launch of the Doha Round in 2001. This latest multilateral negotiating round was structured in the same multi-issue, "single undertaking" approach as the Uruguay Round. In July 2008, a final push to conclude Doha Round negotiations during the waning months of the Bush Administration fell apart due to irreconcilable differences between the U.S., China, and India on agricultural issues.

Frustrated with the intransigence of the new emerging powers, U.S. strategy shifted. Instead of concentrating on the Doha Round, U.S. trade officials shifted their attention to concluding deep-integration RTAs with like-minded allies instead. They sought to re-enact the strategic approach taken when the Uruguay Round had gotten stuck in the late 1980s. Indeed, this historical background played an important role in informing U.S. trade strategy through the Obama Administration.

1. Regional Trade Agreements and the Conclusion of the Uruguay Round

During the Uruguay Round, the U.S. and European Community had sought to push for a comprehensive set of agreements on a wide range of issues, including behind-the-border regulatory issues such as food safety standards, intellectual property, and financial services. Not surprisingly, many developing countries, such as India, balked at this approach. Others such as Japan played hardball with key sectors such as agriculture that they sought to protect. By the late 1980s, the negotiations had ground to a halt.

To break the logjam, the U.S. and its Western European allies adopted the following strategy: If certain GATT members refused to compromise, then these advanced economies would proceed with lowering tariffs amongst themselves through preferential trade agreements and integrate regionally. The idea was to utilize regional trade agreements (RTAs), permitted under GATT Article XXIV, to put pressure on the recalcitrant countries to make further compromises. If the excluded countries still did not, then they would risk being placed at a disadvantage in their key export markets, as the world's two largest economic blocs proceeded ahead without them.

What made U.S. and European policymakers confident that this strategy would work? The crux of this strategy is a concept that economists refer to as trade diversion.[5] Suppose that Countries A, B, and C are regional neighbors exploring the possibility of a RTA. Suppose that Country A, the largest market, currently imposes a 10 percent tariff on widgets. If production costs are 8 percent lower in Country C than in Country A, then given existing tariff levels, consumers in Country A would prefer domestic-made widgets over Country C's widgets. However, suppose that production costs are 15 percent lower in Country X. In that case, then consumers would prefer widgets imported from Country X. Now suppose that Countries A, B, and C enter into a RTA that lowers tariffs on goods traded between them to zero. Widgets made in Country C, not Country X, are now the most competitive in Country A. Because of the RTA, trade is diverted from the excluded country, Country X, to the free trade partner, Country C. This happens whenever gains secured under the free trade agreement are greater than the comparative advantage originally enjoyed by the excluded country's producers. Widget producers in Country X presumably would put pressure on their government to make additional concessions in multilateral negotiations so as to narrow or eliminate the RTA's benefits for their competitors.

The two main agreements that emerged in the early 1990s were the Maastricht Treaty leading to the creation of the European Union (EU) in 1992 and NAFTA in 1993. The hypothesis was that the threat of trade diversion generated from both agreements would alter the political economy of the excluded countries and therefore shift their negotiating stances. This, in turn, would break the impasse in multilateral negotiations, leading to the creation of additional rules favorable to the U.S. and EU. RTAs therefore lay the groundwork for future multilateral rules. Jagdish Bhagwati and other scholars have since coined the term, the "building block" theory of RTAs to describe this strategy.[6]

The overall strategy worked as envisioned. The prospect of trade diversion arising out of the major RTAs put pressure on governments in excluded countries, helping to break the logjam in the Uruguay Round. The U.S., EU, and other advanced economies managed to secure most of what it wanted, including new rules to govern IP and cross-border services trade. Compromises were reached to strengthen judicial enforcement, including the creation of an appellate mechanism. The end result was the replacement of the GATT with the WTO in 1995.

2. TPP and Mega-RTAs as a Response to a Rising China

[5] For an overview of how this concept works in the context of RTAs, see Richard Baldwin & Anthony Venables, *Regional Economic Integration*, *in* 3 HANDBOOK OF INTERNATIONAL ECONOMIC POLICY 1597 (Gene Grossman & Kenneth Rogoff, eds., 1995)

[6] Jagdish Bhagwati & Arvind Panagariya, *The Theory of Preferential Trade Agreements*, 86 AMER. ECON. REV. 82, 83-87 (1996); *see also* JAGDISH BAGHWATI, TERMITES IN THE TRADING SYSTEM (2008); Richard Baldwin & Caroline Freund, *Preferential Trade Agreements and Multilateral Liberalization*, *in* PREFERENTIAL TRADE AGREEMENT POLICIES FOR DEVELOPMENT 121 (Jean-Pierre Chauffour & Jean-Christophe Maur, eds., 2011); Arvind Panagariya, *The Regionalism Debate: An Overview*, 22 WORLD ECON. 455 (1999).

Less than two months after the Geneva talks broke down in July 2008, the U.S. announced that it would join an already ongoing set of trade negotiations among Pacific countries. Those negotiations were re-branded as the TPP. Over time, a total of twelve Asia-Pacific countries representing nearly 40% of global trade would join the TPP negotiations. In 2013, the U.S. launched two other major negotiations for mega-RTAs. The first was Trans-Atlantic Trade and Investment Partnership (TTIP), an attempt to forge a free trade agreement between the U.S. and EU. The second was Trade in Services Agreement (TiSA), an attempt to liberalize services among fifty countries, including all of the major Western economies. Collectively, these came to be known as the mega-regional trade agreements (mega-RTAs).

Absent from all of these negotiations were the emerging powers, including most notably, China. This was by design. If China, India, and other major developing countries refused to make the concessions necessary to conclude the multilateral Doha Round negotiations, then the U.S. and its Western allies would proceed on their own, just as they had done in the early 1990s with NAFTA and the EU. They would build out a new set of 21st Century trade rules and grant additional preferences to those countries willing to sign up for them.

The TPP operated as but one component of this larger plan. It was, however, the lynchpin. The intention was to create a web of regional agreements around China. Complementing the TPP were the TTIP (between U.S.-EU), TiSA (on services), and various other bilateral trade deals between Western allies (EU-Japan, EU-Canada, Japan-Australia). Again, the strategy was to place exporters from China and other excluded countries (*e.g.*, India, Brazil, South Africa) at a disadvantage in their key export markets, thereby raising the pressure on their governments to agree to an updated set of new rules.[7]

Although pundits may speak of the "rise of the rest," among emerging economies, for U.S. trade officials, the chief concern since the late 2000s has been China. Indeed, among emerging economies, China is in a league of its own. China's economy is larger than India, Brazil, Russia, Nigeria, South Africa, and Indonesia's combined.[8] China not only exports more than the six other major emerging economies combined, but it also imports more as well.[9] It has already surpassed the U.S. as the world's largest trading country. Most economists forecast that it will also surpass the U.S. as the world's largest economy at some point in the coming decade. Finally, China is also the only country that could potentially challenge U.S. geopolitical supremacy in the medium-term.

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[7] Jeffrey Schott, *Overview: Understanding the Trans-Pacific Partnership*, *in* TRANS-PACIFIC PARTNERSHIP: AN ASSESSMENT 9, 19 (Cathleen Cimino-Isaacs et al., eds., 2016) ("Staying out would mean some trade discrimination, perhaps upwards of $100 billion in lost exports if the TPP expands but China does not participate.").

[8] For latest GDP statistics, see International Monetary Fund, World Economic Outlook Database, http://www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx.

[9] WORLD TRADE ORGANIZATION, INTERNATIONAL TRADE STATISTICS 2015, 44 (2015)

Cognizant of the West's strategy, China sought entry into some of these negotiations, most notably TiSA.[10] But the U.S. made clear that China was not welcome, at least in the initial negotiating stage.[11] The fear was that with China at the negotiating table, the updated new rules would be watered down and would no longer reflect liberal internationalist principles. Instead, the U.S. strategy was to write high-standard rules first with like-minded allies and then pressure others to accept them as-written. To grant China a drafting role from the onset would defeat the point.

U.S. trade officials made no attempt to disguise or hide its strategy. Instead, they explicitly appealed to liberal internationalist ideals to make the case for its agreement. In a rare Presidential op-ed, President Obama described the United States and China as locked in a contest to "write the rules of the road for trade in the 21st century."[12] America championed "a free and open internet," "respect [of] intellectual property rights [to ensure] creators, artists, filmmakers and entrepreneurs get their due," and "high standards for our workers and our environment."[13] China, on the other hand, championed a model of carving up markets with lingering "unfair competition among government-subsidized, state-owned enterprises."[14] In a changing world, Obama argued, "America should write the rules[;] America should call the shots" and "[o]ther countries should play by the rules that America and our partners set, and not the other way around."[15]

To that end, even though China is not included in the TPP or other mega-RTA negotiations, several provisions were drafted with China in mind. The TPP is the first trade agreement to include a standalone chapter devoted exclusively to rules governing state-owned enterprises (SOEs).[16] It is also the first agreement to contain rules governing data flows, data localization, and mandatory source code disclosure.[17] In addition, the TPP contains more robust rules governing competition policy,[18] labor standards,[19] and environmental standards.[20] The aim is to use the TPP to redress gaps in existing WTO law that are being exploited by China and other emerging economies at the expense of the U.S. and other advanced economies.

Besides seeking to forge new rules to govern new domains of trade and take aim at the "China, Inc." political economy structure, an additional goal is to generate welfare gains among TPP and other treaty partners at the expense of excluded parties such as

[10] Shawn Donnan, *China in Push to Join U.S.-Led $4tn Services Trade Talks*, FIN. TIMES, Sept. 23, 2013.

[11] Alberto Mucci, *The Most Important Free Trade Agreement You've Never Heard Of*, POLITICO, July 7, 2016.

[12] Barack Obama, *The TPP Would Let America, Not China, Lead the Way on Global Trade*, WASH. POST, May 2, 2016.

[13] *Id*.

[14] *Id*.

[15] *Id*.

[16] Trans-Pacific Partnership, chap. 17, Feb. 4, 2016 [hereinafter TPP].

[17] *Id*., chap. 14.

[18] *Id*., chap. 15.

[19] *Id*., chap. 19.

[20] *Id*., chap. 20.

China.[21] As was true of the 1980s, the U.S. and its allies are seeking to keep the multilateral component intact but to fortify the regional component. This move, if successful, weakens the relative payoff of the multilateral bargain for excluded parties.[22] Just as the preferential benefits of NAFTA and EC 1992 diluted the MFN benefits of the GATT, the strategy here is for the TPP, TTIP, TISA, and other bilateral agreements to dilute the MFN benefits of the WTO for China.

In other words, the strategy of the policymakers and experts who championed the mega-RTAs was not to contain China. But it was to force an illiberal China to change – to play by the rules of a trading system molded on liberal ideals, albeit tempered by realist design elements.[23] A rising China which continued to embrace of a state-controlled economic model posed an existential threat to the liberal international order itself – one that America and its Western allies had painstakingly built since Bretton Woods.[24] TPP was a much-needed instrument to repel this threat. Until China changed, U.S. officials resolved to keep an illiberal China consigned to the status of a rules-taker.[25]

The goal therefore was to outmaneuver China by executing what Ashley Tellis calls a "Let's Run Faster" grand strategy.[26] The aim is to "enable the US and its friends to correct the losses suffered from China's imperfect entry into the liberal trading order while at the same time enhancing their own gains from trade."[27] Its objective is to "permit the US to both stay competitive in any upcoming rivalry for hegemony with China and enable it to continue bearing the supernormal costs required to provide those global public goods essential for the success of the liberal international order."[28]

Through this new generation of trade agreements, the liberal internationalists sought to put in place new legal rules that would contract the traditional notion of sovereignty. The new legal rules would tie the hands of all governments that signed onto the new treaties, but in the manner desired by the West and resisted by rising powers, including China.

B. Why U.S. Policymakers Became Convinced that the Mega-RTA Strategy Would Work

[21] Wang Yong, *The Politics of the TPP are Plain: Target China*, 8 GLOBAL ASIA 54, 55 (2013)

[22] Jeffrey Schott, *Overview: Understanding the Trans-Pacific Partnership*, *in* Trans-Pacific Partnership: An Assessment 9, 19 (Cathleen Cimino-Isaacs et al., eds., 2016) ("Staying out would mean some trade discrimination, perhaps upwards of $100 billion in lost exports if the TPP expands but China does not participate.").

[23] For an excellent elaboration of this strategy, see Ashley Tellis, *The Geopolitics of TPP and TTIP*, *in* POWER SHIFTS AND NEW BLOCS IN THE GLOBAL TRADING SYSTEM 93, 105 (Sanjaya Baru & Suvi Dogra, eds., 2015).

[24] For arguments that China is a revisionist power, see MARTIN JACQUES, WHEN CHINA RULES THE WORLD (2009); GIDEON RACHMAN, EASTERNIZATION (2016). Other scholars who are not liberal internationalists also share this view. *See, e.g.*, PETER NAVARRO, DEATH BY CHINA (2011).

[25] *See* President Barack Obama, State of the Union Address, Jan. 20, 2015 ("China wants to write the rules for the world's fastest-growing region. . . . Why should we let that happen? We should write those rules.")

[26] Ashley Tellis, *The Geopolitics of TPP and TTIP*, *in* POWER SHIFTS AND NEW BLOCS IN THE GLOBAL TRADING SYSTEM 93, 105 (Sanjaya Baru & Suvi Dogra, eds., 2015).

[27] *Id*. at 106.

[28] *Id*.

Global production had changed dramatically since the early 1990s, driven by rapid advances in information and communication technology (ICT). Furthermore, China is a much larger economy and market than Japan in the early 1990s. What made American policymakers so confident that the "thick-RTA-as-a-building-block" strategy that had worked in the 1990s could be successfully repeated two decades later?

The intellectual basis for the mega-RTA strategy was a study by Professors Petri, Plummer, and Zhai for the Peterson Institute, a leading U.S. think tank for trade policy.[29] Their economic model found that China would suffer significant trade diversion as a result of the TPP. China's losses would grow quickly from $1 billion initially to $24 billion by 2020 and $47 billion by 2025.[30] Moreover, the study suggested that the marginal difference for China, of joining versus not joining a trade deal modeled on the TPP, was tremendous. China stood to gain over $800 billion, or 7 percent of its projected GDP, if it were to join an eventual regional free trade agreement concluded under the TPP template.[31]

This potential gain amounts to nearly 5% of China's expected GDP – a substantial sum, given that China still depends heavily on exports to generate growth. Excluding Hong Kong, the countries involved in the TPP and TTIP collectively account for approximately two-thirds of China's export markets.[32] The dominant strategy rests on the assumption that the collective market power of the advanced economies is still substantial enough that China can ill afford for its exporters to be placed at a disadvantage vis-à-vis its competitors in TPP countries.

Although the authors would later scale back their estimates significantly in a revised report done after TPP negotiations were concluded in 2016, the narrative stuck. The Peterson Institute report became the key study cited by academics and policymakers alike for justifying the TPP. A 2014 study by Professors Li and Whalley, using a cruder economic model, further corroborated these findings, whereas no academic study emerged in the following years suggesting otherwise.[33] Hence, the U.S. trade and foreign policy establishment came to view the TPP and mega-RTAs as an effective strategy to induce China and other recalcitrant players to adopt new trade rules.

Soon after the Peterson Institute study came out in 2012, an influential study, jointly authored by the World Bank and a Chinese government think tank, was published on the Chinese economy. That study warned that the Chinese economic growth risked stalling without accelerated reforms. In the aftermath of the Chinese Communist Party's Third Plenum touting market reforms in 2013, some even conceived of the TPP

[29] PETER PETRI ET AL., THE TRANS-PACIFIC PARTNERSHIP AND ASIA-PACIFIC INTEGRATION (2012).

[30] *Id*. at 78.

[31] *Id*.

[32] Author's calculations based on UN Comtrade data. *See infra* note 60.

[33] Chunding Li and John Whalley, *China and the Trans-Pacific Partnership: A Numerical Simulation Assessment of the Effects Involved*, WORLD ECON. 169 (2014)

eventually serving a similar role as WTO accession had in the 1990s in spurring Chinese reforms.

The conventional belief among U.S. policymakers, academics, and other experts became that sooner or later, China would accept some degree of the new Western-crafted trade rules promulgated through the TPP and other mega-RTAs.[34] The negative consequences of not joining, when the world's largest economies moved ahead, were too large for even China to ignore.[35] After all, the U.S., EU, and Japan still account for more than half of the global economy. Collectively, their economies are still nearly 3.5 times larger than China's. Were they able to stitch together a new set of trade rules, the prevailing belief is that these new mega-RTAs would operate as a great source of leverage on China and other developing countries.

Once again, they believed that they could use regional deals as a "building block" to apply pressure on excluded countries to make further concessions, lest they risk being shut out of key export markets.[36] If it had worked once, it could work again.

Alas, whether this strategy would have been the case is one which we are no longer in the position to find out. On his first full workday in office, President Trump fulfilled his campaign pledge to withdraw the United States from the Trans-Pacific Partnership (TPP), a mega-regional trade agreement (mega-RTA) between the U.S., Japan, and ten other countries in the Asia-Pacific.[37] Nor was the TPP the only victim. The Trump Administration has brought two other major trade negotiations to a halt: the Trans-Atlantic Trade and Investment Partnership (TTIP) between the United States and European Union (EU), and the Trade in Services Agreement (TiSA), a negotiation between 50 countries to update global services trade rules.

The question that we are left to ponder is whether the electorate's rejection of mega-RTAs was a mistake. Did the U.S. foolishly squander a well-conceived strategy to employ the TPP and other mega-RTAs as building blocks to force an intransigent China to sign on to new rules? Or was it the case that the strategy itself was built on a flawed foundation?

The answer to this question is of immense importance to those who disagree with the anti-globalization, inward retreat now ascendant. If the former is true, then seeking the resurrection of the TPP and other mega-RTAs is the right approach. What are

[34] *See, e.g.*. Michael Green & Matthew Goodman, *After the TPP: the Geopolitics of Asia and the Pacific*, 38 WASH. Q. 19, 29 (2016); Jeffrey Schott et al., *Implications of the Trans-Pacific Partnership for the World Trading System*, PIIE Policy Brief 16-8, July 2016, at 13.

[35] For an example of how the mainstream media also bought into this narrative, see *Into the Home Stretch*, ECONOMIST, July 25, 2015 (reproducing the Peterson Institute chart suggesting that joining the TPP could increase China's GDP by up to five percentage points).

[36] Mireya Solis, *The Case for Trade and the Trans-Pacific Parntership*, *in* BROOKINGS BIG IDEAS FOR AMERICA 138 (Michael O'Hanlon ed., 2016) (describing the TPP as a "bet . . . that by shifting the locus of negotiation to a cluster of countries willing to undertake far-reaching liberalization and to codify novel trade and investment rules, the momentum for trade liberalization can be sustained.")

[37] Presidential Memorandum Regarding Withdrawal of the United States from the Trans-Pacific Partnership, Jan. 23, 2017, https://www.whitehouse.gov/the-press-office/2017/01/23/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific.

needed are simply better policies to weaken domestic resistance in the two-level game. On the other hand, if the latter is true, then the problem runs much deeper. Not only are better policies required at the domestic level, but the entire strategy will require rethinking.

II. WHY THE STRATEGIC RATIONALE FOR THE TPP WOULD NOT HAVE WORKED

Even as the TPP died, U.S. trade experts have clung on to the belief that the strategy of prioritizing thick mega-RTAs would have worked, had it only been brought to fruition.[38] The post-mortem analysis of the TPP has emphasized the Obama Administration's inability to address the domestic dimension of trade as the weak link in the strategy.[39] If that problem somehow could be addressed, the thinking goes, then the U.S. and its Western allies could still forge ahead with crafting next-generation trade rules through thick trade agreements and cajoling others, including China, to accept those rules.

Among those who bemoan the President's confrontational approach, the strategic value of the thick mega-RTA strategy has gone unquestioned. In withdrawing from the TPP, Thomas Friedman wrote, "Trump simply threw away the single most valuable tool America had for shaping the geo-economic future of the region our way and pressuring China to open its markets."[40] Professor Jeffrey Frankel points out that actually "the best way to improve NAFTA," as President Trump is seeking, "would be to return to what was agreed to in the TPP."[41] Some even hold out hope that the remaining eleven countries in the TPP will alter the agreement to allow it to enter into force and that a future U.S. administration will later choose to join on.[42]

I argue that this conviction is misguided. The era when the U.S. and other Western economies could collectively use a deep-integration trade agreement to bend China and other excluded countries toward its desired trade rules has ended. Even if the TPP were to enter into force, it would not have succeeded along these lines envisioned by its proponents. Despite the fact that the U.S., EU, Japan, and other Western allies still

[38] Thomas Bollyky & Edward Alden, *Want America First? Try Free Trade*, N.Y. TIMES, Nov. 16, 2016; Jacques de Lisle & Richard Dasher, *TPP: Why the U.S. Withdrawal Could Be a Boon for China*, KNOWLEDGE@WHARTON, Jan. 27, 2017, http://knowledge.wharton.upenn.edu/article/trans-pacific-partnership/ ("the right path for the U.S. is 'to resurrect much of the TPP,' because 'a good part of it was in America's economic interest.'"); John McLaughlin, *Trump Versus China: What's Really at Stake*, OZY, Dec. 2, 2016, http://www.ozy.com/pov/trump-versus-china-whats-really-at-stake/74298; Jeffrey Schott, *US Trade Policy Option in the Pacific Basin: Bigger is Better*, PIIE Policy Brief 17-7, Feb. 2017.

[39] Peter Goodman, *More Wealth, More Jobs, But Not for Everyone: What Fuels the Backlash on Trade*, N.Y. TIMES, Sept. 28, 2016; Reihan Salam, *Why the Trans-Pacific Partnership Failed*, SLATE, Jan. 25, 2017, http://www.slate.com/articles/news_and_politics/politics/2017/01/why_the_trans_pacific_partnership_failed.html.

[40] Thomas Friedman, *Trump is China's Chump*, N.Y. TIMES, June 27, 2017.

[41] Jeffrey Frankel, *Can Donald Trump Better Renegotiate Nafta? Yes, by Bringing Back TPP*, GUARDIAN, April 25, 2017.

[42] *Some in Congress Back Implementing TPP Trade Deal Even Without U.S., Amari Says*, JAPAN TIMES, March 11, 2017; *see also* Matthias Helble, *Salvaging the Trans-Pacific Partnership: Building Blocks for Regional and Multilateral Trade Opening*? ADBI Working Paper No. 695, March 2017;

command over two-thirds of the global economy, the old order has already crumbled. No longer can the threat of exclusion from a preferential trade arrangement suffice to cajole a rising trade power to acquiesce and accept updated rules set by the established powers. Rather, I argue that we have already entered into a new era of trade rule-making – one in which the U.S. and its allies can no longer singlehandedly dictate the terms for updating global trade rules.

How is it that trade policymaking elites failed to recognize this important transformation? Why did they cling to an outdated notion of the global trading order and ultimately center their argument for the TPP on the notion of economic statecraft?

The policy failure arises from the fact that scholars continue to rely upon a set of outdated frameworks to analyze the impact of trade agreements. The world in which trade takes place has altered dramatically over the past two decades. Production is increasingly configured along global value chains that span borders; no longer are many goods produced exclusively in one country with components sourced from within.[43] The substance of trade agreements has also changed dramatically. Whereas negotiators once focused primarily on lowering tariffs, today, they devote increasing attention to non-tariff barriers. The TPP focused on a wide range of issues such as regulatory coherence, investment, competition policy, intellectual property, etc.

In particular, three scholarly shortcomings have played a critical part in leading policy astray. First, scholars are not properly analyzing the dynamics of trade diversion from a trade agreement. In other words, they are not correctly deducing the impact for a country of being left out of a trade agreement. Second, scholars are also not engaging in proper in-depth analyses of the impact of the legal rules of origin (ROOs) of trade agreements. ROOs play a vital role in mega-RTAs; yet, scholarly analyses of ROOs is critically lacking. Finally, even though scholars recognize that trade is a two-level game and that the political economy dynamics at the domestic level play a critical role, they have failed to engage deeply in their analyses of the domestic-level dynamics of non-Western democracies. Nowhere is this more the case than in China, where scholarly analyses of the internal dynamics of Chinese trade policymaking is largely absent.

I argue that these three failures have collectively led scholars to overestimate the potential impact of a TPP on China. This, in turn, fueled an incorrect notion that the TPP and other mega-RTAs could serve as an instrument to cajole China and other emerging powers to play by updated rules set by America and its partners.

Part II examines each of the three shortcomings in-depth. Each section begins with an explanation of the conventional analysis and why it falls short. I then discuss the additional original analysis that I undertook to remedy existing problems and my findings. Overall, they undermine the core assumption underlying the strategy. Even

[43] *See generally* DEBORAH ELMS & PATRICK LOW, EDS. GLOBAL VALUE CHAINS IN A CHANGING WORLD (2013).

had the TPP been ratified, it is unlikely that it would have effectively altered China's trade posture and revitalized a Western-led global trade order.

A. A Failure to Properly Assess the Trade Diversion Impact

For the TPP to have worked in applying pressure on China to accept new trade rules drafted by the U.S. and its allies, it would have had to trigger significant economic costs for China. In other words, it would have had to threaten to unleash significant trade diversion from China toward TPP countries, such as Vietnam and Malaysia, which would benefit from tariff elimination and other advantages afforded by the TPP.

Some trade diversion is bound to occur with any trade agreement, but the critical question is its scale. If small enough, then the excluded party may simply bear the cost. However, if the costs are large, then it will be forced to reconsider its intransigence to the new rules. The excluded party may then seek to accede to the RTA itself or negotiate further bilateral or multilateral concessions with the RTA partners in order to lessen the negative trade diversion impact. Such was the case in the early 1990s when NAFTA and EC-1992 persuaded Japan, India, and others to take a more flexible negotiating position, thereby allowing the Uruguay Round to conclude.[44]

Just how large would this impact have been? I argue that the conventional methods has led scholars to overestimate the trade diversion impact for China from the TPP. The

1. Resorting to Competing RTAs to Effectively Counter Trade Diversion

Suppose that a web of mega-RTAs, including the TPP, did actually emerge, as liberal internationalists hoped. An excluded country's choices on how to respond are not simply limited to (a) seeking to join the new mega-RTA (*i.e.*, TPP), (b) making compromises in multilateral negotiations so as to neutralize the RTA's impact, or (c) doing nothing. Instead, the excluded country could respond with a corresponding trade liberalization initiative of its own to offset the mega-RTA's impact.

To their credit, Petri, Plummer, and Zhai recognized, rather than ignored, this possibility.[45] However, at the time that their 2012 study was done, this was merely a hypothetical possibility and hence not easily quantifiable. But it would soon become reality.

In November 2012, China launched its counter-initiative to the TPP. Sixteen countries, including China, announced the start of negotiations for the Regional Comprehensive Economic Partnership (RCEP). The proposed free trade agreement sought to encompass all of the major economies of East and Southeast Asia, accounting for nearly half of the world's population and 30 percent of its GDP. Included in the RCEP initiative were all seven of the TPP countries in the Western Pacific (*i.e.*, Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam). Notably

[44] MICHAEL BOSKIN, NAFTA AT 20, 19 (2014).

[45] PETRI ET AL. *supra* note 29, at 79.

absent was the United States. The RCEP is also a relatively thinner trade agreement; unlike the TPP, it does not aim for strong environmental or labor standards.

Note that unlike other international legal regimes, the binary of "multilateralism vs. bilateralism/regionalism" does not hold for the trade regime. The regime is designed explicitly to allow both to co-exist. Moreover, WTO members are allowed to sign on to multiple bilateral/regional regimes. Nothing prevents countries from signing on to both American-led and Chinese-led RTAs.

Through the RCEP, China could aim to secure similar concessions to neutralize any comparative advantage that firms in TPP countries achieved through the TPP. Doing so minimizes the trade diversion threat for China from the TPP. In today's world, so long as one has the economic heft to conclude one's own competing RTA, the negative economic consequences of being excluded from a RTA are no longer as grave as they once were.

It remains unclear whether other emerging economies, such as India or Brazil, necessarily possess such power yet. But China clearly already does. For many Asian economies (including key U.S. allies such as Australia, Japan, and South Korea), China is already the largest and most important export market. As much as they may align with an American liberal internationalist outlook, they will still choose to engage China for economic reasons.

The authors of the Peterson Institute study readily admit that once RCEP is added to the mix, the negative economic consequences of not signing on to the TPP fall dramatically for China. In other words, TPP provides the U.S. with nowhere close to the leverage once believed. Petri and Plummer's revised study found TPP's negative trade diversion effect for China to be 83% smaller than what they had originally estimated in 2012.[46] One might think that a revision of this magnitude would have merited attention. But it did not. Coverage of the revised Peterson Institute report focused primarily on TPP's domestic impact. So far as I am aware, no academic paper to date has highlighted the extent to which Professors Petri and Plummer scaled back their trade diversion calculations for China in their 2016 study. Nor did this shift receive any attention in the mainstream media or even expert blogs. Instead, thenegative implications of their revised findings for the TPP's geopolitical impact were largely ignored.

What of the five remaining TPP markets in the Western Hemisphere? Note that China already has a free trade agreement with Chile and with Peru. It need not worry about significant trade diversion from the TPP in those markets. Of the remaining three NAFTA markets, China has also announced plans to negotiate separate free trade deals with Canada and Mexico. Both negotiations again present China with a means to offset any threat of potential trade diversion arising from TPP.

[46] The revised study found that China would suffer only $8 billion in losses by 2025 as compared to $47 billion in the original study. *Compare* [pincite to both reports]

In other words, today's trade negotiating dynamic is starkly different from that which existed during the Uruguay Round. Unlike NAFTA or the EU, today's mega-RTAs will not trigger the creation of a common economic bloc from which Chinese firms will find themselves excluded. Instead, by picking off the TPP countries one-by-one with its own trade deals, China can effectively counter the threat of trade diversion from TPP and U.S.-led mega-RTAs to its exporters.

But the futility of resorting to thick mega-RTAs to coerce China and other excluded countries to accept revised global trade rules runs even deeper. Even if China did not engage in a strategy of competing trade initiatives or those Chinese-led efforts fell apart, the TPP and other U.S.-led mega-RTAs would still prove incapable of cajoling China to sign on to new trade rules.

2. The Limits of CGE Modeling on Estimating Trade Diversion

Analyses to date of the potential cost to the China from being excluded from the TPP rely upon use of an economic modeling instrument known as the computable general equilibrium (CGE) models. By using data to analyze how changes in one part of the economy affects other parts, a CGE model affords a means to examine how a given trade agreement will affect exports from a party not included in that agreement.

In 2016, after the actual TPP text was released, Petri and Plummer revised the estimate of the cost to China downward to $18 billion in 2030.[47] Nevertheless, China is still expected to be the country most adversely affected by the TPP. Petri and Plummer find that roughly 40% of the total negative regional economic fallout for excluded parties will fall on China.[48] The adverse impact on China is expected to 2.5 greater than that for any other non-TPP country, such as Thailand or India.[49]

Li and Whalley, also relying on a general equilibrium model, similarly find that China will suffer a net welfare loss as a result of the TPP.[50] They estimate this effect to be on the order of -0.14% of China's total welfare, which translates into a loss of roughly $14 billion (in 2014 dollars).[51] Note that this figure is roughly of the same magnitude as Petri and Plummer's 2016 results.

Despite the scaling back of the expected trade diversion estimates over time, the conventional belief of the TPP's positive benefit for the United States, at China's expense, continued to hold. At a time when the Chinese economy is slowing, China cannot afford the potential economic losses that will arise from being shut out of these new trade agreements. TPP proponents therefore have come to believe that the TPP

[47] Peter Petri & Michael Plummer, *The Economic Effects of the Trans-Pacific Partnership: New Estimates* (PIIE Working Paper 16-2, 2016), at 20.

[48] *Id*.

[49] *Id*.

[50] Note that their two-good, two-factor model is even simpler than the CGE model relying on GTAP data. Chunding Li & John Whalley, *China and the Trans-Pacific Partnership*, 37 WORLD ECON. 169, 170 (2014).

[51] *Id*. at 182 (assuming 50% elimination of non-tariff barriers).

will be effective in changing Chinese trade posture toward becoming more accommodating to Western demands to rewrite the rules of global trade.

A closer look at the actual economic models, however, reveals major limitations. CGE models worked well when trade agreements focused primarily on tariffs and goods were made primarily in one country. But as trade agreements increasingly focus on non-tariff issues and goods are produced through global supply chains, the estimates produced by CGE models are increasingly imprecise.[52]

Furthermore, the data used as inputs for CGE models is not collected at the level of granularity necessary to model trade dynamics accurately. Most CGE models draw on the GTAP database. GTAP aggregates trade data into only fifty-seven goods and services.[53] For example, all electronic equipment is bundled together as one category. No distinction is made between mainframe routers, laptops, smartphones, or their component parts.

With this approach, it becomes very difficult to capture any of the supply chain dynamics that underlie global trade today.[54] The *Economist* magazine went so far as to warn that "precise CGE forecasts ought to be taken with a grain of salt."[55] Nevertheless, CGE models remain the basis for policy decisions. With short statutory time frames for churning out the required economic analyses, U.S. government agencies have little choice but to rely upon these increasingly imperfect tools. Moreover, even if they sought to do otherwise, a replacement model does not yet exist. Economists are only beginning to explore potential alternative ways to model the new dynamics of global trade.

Yet, it is on the foundations of these increasingly imprecise economic analyses that major trade policy decisions are being made. Although trade agreements are more complicated legally than ever, legal scholars have been more than willing to cede the ground of considering the geostrategic implications of trade agreements arising from trade diversion to economists, rather than develop supplementary analyses of their own.

3. Additional Analyses

Consider the following: If, as these models suggest, China stands to lose billions of dollars of trade each year from not joining the TPP, then we ought to be able to identify specific Chinese export products that face the threat of trade diversion in specific markets. The aggregate sum of the losses of these products in each of the individual TPP markets should total roughly the amount asserted by the scholars based on the CGE models.

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[52] Marco Fugazza & Jean-Christophe Maur, *Non-Tariff Barriers in CGE Models: How Useful for Policy?* 30 J. POL'Y MODEL. 475 (2008).

[53] Global Trade Analysis Project, GTAP 9 Data Base Sectors, https://www.gtap.agecon.purdue.edu/databases/v9/v9_sectors.asp

[54] *See* Emily Blanchard et al., *Global Supply Chains and Trade Policy* 1 (NBER Working Paper N0. 21883, 2016) ("[G]lobal supply chains are largely absent in theoretical and empirical analysis of trade policy.").

[55] *A Weighting Game*, ECONOMIST, May 30, 2015.

Note that the existing economic models are not equipped to answer the question of which particular Chinese products are at risk. Petri and Plummer's model considers only aggregate data for nineteen sectors; it does not analyze individual products.[56] Li and Whalley's model is even more simple and stylized; it does not even engage with sector-level data.[57] Yet, intuitively, we know global trade is much more complicated. In today's world of global supply chains, an equilibrium analysis at this high of an aggregate level is unlikely to properly capture the dynamic effects of potential trade diversion from a trade agreement.[58]

The problem is not a shortage of data. Detailed product-level data is captured and regularly reported by governments to the WTO and United Nations. Instead, the problem is that existing economic models are unable to make use of this data.[59] These limitations force economists to restrict their analysis to sector-aggregated data.

However, without corroboration from detailed product-level data, one cannot be certain that the conclusions drawn from the economic models are necessarily correct. Below, I discuss how additional under-examined data can be brought to bear through use of a partial equilibrium model to further examine the trade diversion phenomena. The important difference is that the partial equilibrium approach can take stock of disaggregated product-level data, whereas the CGE model cannot.

I draw on the product-specific trade data found at the HS-6 level in the UN Comtrade database.[60] This allows for a much finer level of disaggregated data analysis. With the conventional approach, the analysis draws only on data aggregated at a sectoral, rather than product-specific, level. Consequently, the much-touted Petri and Plummer CGE model considered diversion effects for only nineteen aggregated sectors. Yet, today's cross-border trade is much more finely divided along value chains; consideration of aggregated sector-wide trade diversion misses the point. Examining HS-6 level data using a partial equilibrium approach employed allows for consideration of the trade diversion effects for over 5,000 products – thereby, capturing much more accurately the intricacies of contemporary trade oriented around global supply and value chains.

For each product in each TPP market for which China does not have an existing FTA, I identify a set of trading partners whose exports will enjoy a benefit in the form of reduced tariffs as a result of the TPP. Note that this may not be the full set of TPP trading partners. That is, some TPP trading partners may already enjoy tariff-free access as a result of an existing FTA or a preferences program. For example, Canadian and Mexican exports to the U.S. already enjoy tariff-free access as a result of NAFTA; therefore, there is no change in the relative terms of trade faced by a Chinese producer

[56] *See* Petri & Plummer, *supra* note 47, at 27.

[57] *See* Li & Whalley, *supra* note 50, at 173 (explaining that the stylized model assumes "each country produces two goods with two factors").

[58] *See* Blanchard et al., *supra* note 54 (finding supply chain dynamics affect tariff policy).

[59] *Id*. (noting how the heterogeneity of supply chains makes it difficult for models to utilize such data).

[60] United Nations, UN Comtrade Database, https://comtrade.un.org/.

competing against a Mexican producer in the U.S. market on account of TPP on tariffs alone.[61] To determine the set of pre-existing FTAs and preference programs, I draw on the data available in the WTO's Regional Trade Agreements Database and Preferential Trade Arrangements Database.[62] As necessary, this is corroborated with information provided by national governments.

The methodology used to determine the trade diversion effect for each good in each jurisdiction is in line with that employed by the United Nations Conference on Trade and Development (UNCTAD) and the World Bank through its SMART simulation program that is commonly used by trade negotiators.[63]

In order to determine the trade diversion effect for any particular good, it is helpful to break the analysis into two parts. The first step is to determine the relative price change (*dRP*/*RP*) as a result of the reduced tariffs under the TPP agreement. The reduction of tariffs for the new TPP partner leads to a relative gain in the terms of trade for its producers vis-à-vis Chinese producers. This is captured by the equation:

$$\frac{dRP^{TPP}}{RP^{TPP}} = \frac{1 + T_1^{TPP}}{1 + T_0^{TPP}} - 1$$

In other words, the relative price change is calculated as a function of the existing MFN applied tariff rate (T_0) and the new tariff rate under the TPP (T_1). Note that there is no change in the tariffs applied to Chinese exports to the TPP market as a result of the TPP. Data for the MFN applied tariff rates are drawn from the WTO database on tariff data.[64]

The literature has long questioned whether the full effect of lowered tariffs is passed through to consumer price, expressing skepticism that it is.[65] Note that because of the lack of market-specific or product-specific data on pass-through rates, I assume full

[61] As discussed in the paper, such change may be possible as a result of changes in rules-of-origin or other elements of the treaty. This effect is considered separately. *See supra* Part II.B.

[62] *See* WTO, REGIONAL TRADE AGREEMENTS, https://www.wto.org/english/tratop_e/region_e/region_e.htm.

[63] For examples of this approach, see e.g. Lorenza Jachia & Ethél Teljeur, *Free Trade Between South Africa and the European Union* (UNCTAD Discussion Paper No. 141, 1999); Longyue Zhao, Mariem Malouche, Richard Newfarmer, *China's Emerging Regional Trade Policy*, 1 J. CHINESE ECON. FOREIGN TRADE STUD. 21 (2008); Mustapha Sadni Jallab, Lahsen Abdelkmalki, Rene Sandretto, *The Free Trade Agreement Between the United States and Morocco: The Importance of a Gradual and Asymmetric Agreement*, 22 J. ECON. INTEGRATION 852 (2007).

[64] *See* WTO, WTO CONSOLIDATED TARIFF SCHEDULES (CTS) DATABASE, http://tariffdata.wto.org/Default.aspx?culture=en-US.

[65] For a classic discussion on this question, see Mordechai E. Kreinin, *Effect of Tariff Changes on the Prices and Volume of Imports*, 51 AM. ECON. REV. 310, 311 (1961) ("In all probability only part of the reduction would be passed on to the U.S. consumer, the remainder being reaped by foreign suppliers in the form of higher export prices"). For examples of papers finding pass-through rates below one, see Jun Han et al., *Market Structure, Imperfect Tariff Pass-Through, and Tariff Welfare in Urban China*, 100 J. INT'L ECON. 220 (2016); Beyza Ural Marchand, *Tariff Pass-Through and the Effect of Trade Liberalization on Household Welfare*, 99 J. DEV. ECON. 265 (2012); Alessandro Nicita, *The Price Effect of Tariff Liberalization: Measuring the Impact on Household Welfare*, 89 J. DEV. ECON. 19 (2009).

pass-through. This assumption can be easily tweaked to result in a lower trade diversion effect, if desired.

In order to determine the trade diversion effect for Chinese exports to the particular TPP market, we also need to know the elasticity of import substitution (E_s) away from Chinese goods toward that of the new FTA partner benefiting from the TPP. Kee, Nicita, and Olarreaga have used data from the UN Comtrade database to estimate import demand elasticities for various countries, which include the TPP markets in question here.[66] Their estimates are disaggregated to products at the HS-6 level. Where an estimate does not exist, I assume an elasticity of -1.5, in line with the default elasticity used by the UNCTAD/World Bank SMART Simulation and what has often been used in the relevant trade literature.[67]

Having calculated the relative price change and obtained the import demand elasticity for each specific product at the HS-6 level for each market, the trade diversion effect for the particular good can be calculated using the formula:

$$TD^{TPP} = \frac{M^{TPP} * M^{CHN} * \frac{dRP^{TPP}}{RP^{TPP}} * E_s}{M^{TPP} + M^{CHN} + M^{TPP} * \frac{dRP^{TPP}}{RP^{TPP}} * E_s}$$

Note that the trade diversion for Chinese imports of any given good in a particular TPP market is a function of:

(1) The change in relative price;
(2) The elasticity of substitution between the good from the new FTA partner (resulting out of the TPP) and China; and
(3) The existing level of imports (M^{CHN}) from China and the existing level of imports from the new FTA partner resulting out of the TPP (M^{TPP}).

Existing import levels are also drawn from the UN Comtrade database.

4. Additional Analyses

[66] Hiau Looi Kee, et al., *Import Demand Elasticities and Trade Distortions*, 90 REV. ECON. STATISTICS 666 (2008).

[67] *See* Jachia & Teljeur, *supra* note 63, at 9. *See also Feenstra* et al, *In Search of the Armington Elasticity*, (University of California - Davis, unpublished manuscript) (2014); David K. Backus et al., *Dynamics of the Trade Balance and the Terms of Trade: The J-Curve?* 84 AM. ECON. REV., 84, 91-92 (1994); M. Ayhan Kose & Kei-Mu Yi, *Can the Standard International Business Cycle Model Explain the Relation between Trade and Comovement?* 68 J. INT'L ECON. 267, 277 (2006). Some have suggested that an even-lower default elasticity rate. *See, e.g.*, Stephen Tokarick, *A Method for Calculating Export Supply and Import Demand Elasticities* (IMF Working Paper WP/10/180, 2010) at 12. *See also* Kim J. Ruhl, *The International Elasticity Puzzle* at 2 (University of Texas - Austin, unpublished manuscript), https://core.ac.uk/download/pdf/6344759.pdf ("IRBC models commonly use Armington elasticities around 1.5, though sensitivity analysis suggests values even lower than this may be appropriate.")

My analysis reveals three important findings: First, within the four markets (U.S., Japan, Canada, and Mexico) in which China does not have a pre-existing free trade agreement, many of China's top exports will not face any competitive pressure from the TPP or any other U.S.-led trade agreement. A key reason is that China's position in many of these top export product markets is so dominant that it faces no sizeable competition from TPP countries that are new (as opposed to existing) free trade partners.

Of China's top 500 exports to the U.S., in nearly half (233) of these product markets, China's market position is so dominant such that China accounts for 50% or more of the total share of imports of that product. Furthermore, for more than half (268) of the top 500 products, the collective share of imports from new FTA partners of the U.S. is less than 5%. Table 2 shows that the same patterns also holds true for Canada, Mexico, and Japan.

Table 2. Competitive Market Position of Top 500 Chinese Exports vis-à-vis New FTA Partners[68] in Select TPP Markets

	Number of Products for which China's Share of Total Imports > 50%	Number of Products for which the Collective Import Share of New FTA Partners in the TPP < 5%
United States	233	268
Japan	339	339
Canada	172	338
Mexico	164	429

Source: Author's analyses of UN Comtrade data

What this data reveals is that for many product markets, Chinese producers focus on different sectors and/or occupy essentially different parts of the supply chain than producers in new FTA countries. Because China's position in these product markets is so entrenched and its competitors' capabilities are non-existent or so under-developed, it is unlikely that any firm would shift its production away from China, even with the tariff advantages arising out of the TPP. So many of today's global production chains run through China that even if a policymaker intentionally sought to use a mega-RTA to generate economic harm for China, it would take some time to do so. For example, it would take years for Apple and its partners to recreate a supply-chain ecosystem necessary to shift smartphone production away from China.

[68] New FTA partner is defined as a TPP partner with which the country did not have a pre-existing FTA prior to the TPP.

What about those markets where there is already existing competitive overlap, or where the possibility to substitute away from China exists? Could the TPP and other mega-RTAs might induce a shift of production, and therefore, trade away from China? A second key finding is that for most products, it would not. Instead, the TPP's impact may prove immaterial.

If one examines China's top exports to the four TPP markets in which it does not have an existing free trade agreement, one finds that many of these top export products are already not subject to tariffs due to existing WTO commitments. For example, of China's top 25 exports to the Japan, more than two-thirds already enter the country tariff-free. Similarly, more than half of China's top 25 exports to the U.S. and Mexico are also not subject to any tariffs. Therefore, in many important product markets, China's competitors gain no net advantage from the TPP. Furthermore, through the WTO's two Information Technology Agreements, most TPP countries have already committed to grant tariff-free access to imports of over 300 information technology goods from all WTO members, including China.

In each of the four markets, I examine the patterns of trade for China's top 500 export goods. Collectively, they also provide further indication of the lack of pressure that the TPP would have asserted on China. In many of these products, trade diversion is unlikely to arise because (a) the market position of Chinese firms is so dominant and entrenched, and/or because the existing tariffs are already low or non-existent. This is especially true of the higher-value-added technology goods that drive Chinese industrial policy and for which China seeks to expand its exports.

Consider the findings from the U.S. market. Of China's top 500 export goods into the U.S. market, only 192 represent products for which either: (a) the collective share of new free trade partners resulting from the TPP exceeds 10 percent, or (b) the spread between China's share of imports and the collective share of new partners' imports is less than 20 percent. Of these products, in nearly three-fifths (112), the applied tariff rate is below 2%. The cost advantage to be gained from substituting away from China is minimal and may not be worth the switching costs.[69] Of the 192 products examined, applied tariff rates exceed 5% for only 49 products; if we apply an even higher threshold of 10%, then the number of products drops to a mere 29. These are concentrated almost exclusively in the textile and apparel industries.[70]

Table 3 shows the corresponding figures for the Mexican, Canadian, and Japanese markets. Again, the majority of China's top exports to each of these markets do not face competition from exports from new free trade partners. Even for goods where competitive overlap exists, existing MFN tariffs are mostly quite low. Therefore, the

[69] In more than half of these instances (67 of the 112 product markets), the advantage is non-existent because the product is not subject to any tariffs.

[70] Of the 29 items, two are footwear-related, with the remainder all being textiles and apparel. See Appendix B.1 for more details.

TPP, had it come into force, would not have impacted the terms of competition much, if at all, for the vast majority of China's top exports.

Table 3. Breakdown of MFN Applied Tariff Rates in Select TPP Markets for Top 500 Chinese Exports Facing Competitive Overlap with TPP Countries[71]

	Number of Top 500 Chinese Export Products Facing Competitive Overlap	Number of Products Facing Competitive Overlap with MFN Applied Tariff Rate in the Category Below			
		0%	≤ 2%	≥5%	≥10%
United States	192	67	112	49	29
Japan	118	78	87	15	9
Canada	222	134	140	49	27
Mexico	205	101	133	54	29

Source: Author's analyses of UN Comtrade data and WTO Consolidated Tariff Schedule data

None of the points above is apparent from the results of the CGE model that lies at the foundation of the conventional approach. Because the CGE model relies upon data aggregated the sector level, it is unable to tease out these intricate differences in trade diversion across different points of the supply chain. Instead, the CGE model assumes a degree of sector-wide trade diversion that is no longer reflective of the realities of 21st Century trade.

What about the argument that the main threat for Chinese exporters arises not from being competitively disadvantaged via tariffs but from being left out of the standard-setting processes within the TPP region? A closer look at the treaty text itself highlights why this argument also rests on shaky analytical foundations. Many of the key standards-related provisions of the TPP simply re-affirm existing WTO law.[72] To the extent that the provisions actually exceed what is required in existing WTO agreements, many of the new requirements are procedural in nature and concern the transparency of standards-setting processes.[73] In other words, they do not seek to shut out Chinese firms from participating in the standards-setting processes nor necessarily disadvantage them per se. Few provisions, if any, actually require TPP governments to harmonize on a product standard from which China is excluded. Even if a future mega-

[71] Competitive overlap is deemed to exist for any product for which either: (a) the collective share of new free trade partners resulting from the TPP exceeds 10 percent, or (b) the difference between China's share of imports and the collective share of new partners' imports is less than 20 percent.

[72] *See, e.g.*, TPP, arts. 8.4-8.6.

[73] *Id.*, art. 8.7.

RTA did so, Chinese firms could simply retool their own product specifications and export production processes to align with these new standards.

Third, my analysis reveals that of the Chinese exporters actually threatened by the TPP, most are concentrated largely in "sunset" industries. These are industries from which China is already planning to transition away as its labor costs rise and it seeks to move up the global value chain. The Chinese exports that would have been most negatively impacted by the TPP are: (1) jerseys, sweaters, and outwear; (2) sports footwear; and (3) other footwear with rubber or plastic soles. Such industries may be important for sustaining near-term employment in China, but they are not crucial to China's longer-term economic development plans.

Why is understanding the exact competition of where trade diversion will take place important? Both the CGE model and my partial-equilibrium analysis arrives at roughly the same estimate of the level of trade diversion in the immediate aftermath of the TPP's conclusion. This is roughly in the order of $1 billion. Such a figure is a mere drop in the bucket for China, considering that it exported more than $2 trillion in 2015. The near-term threat would not have been sufficient to spark China to act.

However, a key finding of the Peterson Institute report was that the scale of trade diversion losses for China from the TPP would grow over time. Specifically, the revised 2016 report suggested that Chinese trade diversion losses would grow eight-fold in a decade, and then more than double between 2025 and 2030.[74] It is this finding of long-term increasing trade diversion which provides ammunition to those who believed that the TPP and other mega-RTAs would offer the U.S. important leverage over China.

Once armed with the knowledge of the exact products where competitive overlap exists, we can see why this conclusion is likely to be wrong. The vast majority of impacted products are in sectors, such as textiles, footwear, and apparel, where China is preparing to transition production offshore anyways as its labor-cost advantage disappears. In other words, these are "sunset" industries in which Chinese exports are already expected to decline, even without the TPP. Outside of these already-shrinking sectors, Chinese exporters face little competitive threat from the TPP. Therefore, it is hard to sketch out a pathway for which Chinese trade diversion losses would grow in the manner suggested by the revised 2016 Peterson Institute report. Instead, my analyses suggest that the Chinese exporters will prove to be more resilient in the wake of TPP (or any exclusionary U.S.-led mega-RTA) than CGE models suggest. This is true, even if competing Chinese-led trade initiatives such as RCEP never come to fruition.

The economic threat to China of being excluded from the TPP therefore appears to be grossly over-exaggerated. With less than 0.1% of Chinese exports likely to lose out from trade diversion and most of the high-value-added sectors left largely unaffected,

[74] *See supra* note 47.

it is hard to see why China would ameliorate its trade policy to accommodate U.S. interests in the wake of the TPP and other mega-RTAs.

Therefore, once a more robust analysis of actual product-level trade dynamics is conducted, the core geopolitical assumption underlying the mega-RTA strategy is called into question. The exact mechanism through which the TPP and other mega-RTAs allows the U.S. to apply additional pressure on China to open its markets, as Thomas Friedman and other pro-TPP proponents suggest it would, is unclear.

B. Lax Rules of Origin Can Serve to Further Undermine the Mega-RTA's Impact

With production increasingly disaggregated across borders, the nationality of a given product or service becomes more difficult to concern. Rules of origin (ROO) take on increasing importance in a trade agreement.

What exactly are rules of origin? These are the technical rules upon which parties to a trade agreement agree to determine when a given good or service is considered to originate from within the free trade zone as opposed to when it does not. With a complex good composed of inputs sourced from multiple countries, legal rules are required to determine that good's origin.

Not surprisingly, in the wake of the Great Unbundling, ROOs have become one of the most contentious and important issues of contemporary trade negotiations. Consider what transpired during the final stage of TPP negotiations. The U.S. and Japan, the two largest TPP economies, had entrenched negotiating differences over was autos and auto parts.[75] Given that autos constitute an important manufacturing sector for both countries, this is not altogether surprising. However, the main stumbling block in these negotiations was not tariffs or other non-tariff barriers. Instead, the two sides deadlocked over the ROOs that would apply.[76] In fact, the stalemate became so debilitating that negotiators needed to hold a special round devoted exclusively to this issue.[77] Only once this impasse was finally broken did the other negotiating pieces finally fall into place;[78] the TPP concluded soon after the U.S. and Japan reached a compromise on auto ROOs.

For the complex goods that account for an important share of global trade, negotiations over ROOs become arguably as important, if not more, than those over tariffs. If the rules set the threshold too low, then it becomes relatively easy for non-parties to the agreement to benefit from the trade agreement via trans-shipment and minor alterations. On the other hand, if the rules set the threshold too high, they can hinder firms with complex global supply chains. The particular rules of origin found

[75] William Mauldin & Dudley Althaus, *Auto-Parts Dispute Taps the Brakes on Pacific Trade Deal*, WALL ST. J., Sept. 3, 2015.

[76] *Id*.; RAJ BHALA, TPP OBJECTIVELY 243-45 (2016).

[77] *Four-Party Auto Talks Resume: At Least Two Ministers Expected to Skip Meeting*, INSIDE U.S. TRADE, Sept. 28, 2015.

[78] Les Whittington, *Trans-Pacific Partnership Deal Could Be Near After Auto Compromise*, TORONTO STAR, Oct. 2, 2015.

within an agreement, therefore, have important implications not only for the parties to the FTA, but also for excluded countries.

1. The Conventional Analysis and its Limits

ROOs are yet another area where existing analytical frameworks for trade agreements fall short. Scholars are often tempted to transform a trade agreement's non-tariff components into a tariff-equivalent.[79] This figure is then plugged into the economic model to analyze that component's impact. The problem is that this type of transformation is simply not possible for ROOs, as long as one is wed to a CGE model or any other economic model that draws on GTAP data. ROOs largely affect intra-sector trade flows of upstream inputs and the distribution of gains from such flows. GTAP data is simply not collected at granular enough of a level to perform this analysis. Consequently, many of the studies analyzing the TPP's impact, which subsequently formed the basis for the dominant strategy, largely sidestepped any analysis of its ROOs.

The U.S. ITC analysis is one of the few that openly considers the impact of ROOs for specific sectors in its findings. However, the economic model utilized cannot incorporate ROO shifts; instead, the report simply details the directional impact.[80] The report further acknowledges openly how the aggregated data required of a CGE model may cause distortions in the results.[81]

Because of the highly legal nature of these rules, one might expect legal scholars to fill in the void left by economists. However, only Raj Bhala has provided an extensive analysis of TPP's ROOs in his book-length discussion of the agreement.[82] Despite the central importance of the topic, so far as I am aware, none of the articles published by legal scholars on the TPP discuss ROOs in-depth. This is in stark contrast to the early 1990s when several legal scholars analyzed ROOs in the context of NAFTA.[83] It is also in contrast to the rest of the world, where discussion of ROO permeates the legal scholarship.[84]

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[79] *See, e.g.*, Petri & Plummer, *supra* note 47, at 27-28 (discussing adjustments made for non-tariff barriers)

[80] *See, e.g.*, U.S. International Trade Commission, Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and Specific Industry Sectors 88 (USITC Publication 4607, 2016), at 238-39, 260-61, & 287.

[81] *Id.*, p. 228.

[82] RAJ BHALA, TPP OBJECTIVELY 229-247 (2016).

[83] In the immediate aftermath of these trade agreements, several full-length articles devoted specifically to ROOs were published in top international law journals. *See, e.g.*, Richard Steinberg, *Antidotes to Regionalism: Responses to Trade Diversion Effects of the North American Free Trade Agreement*, 29 STAN. J. INT'L L. 315 (1993); Joseph LaNasa III, *Rules of Origin Under the North American Free Trade Agreement*, 34 HARV. J. INT'L L. 381 (1993); Joseph LaNasa III, *Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them*, 90 AM. J. INT'L L. 625(1996).

[84] *See* J.H.H. Weiler et al., International and Regional Trade Law – Unit III: Rules of Origin, *available at* http://www.jeanmonnetprogram.org/wp-content/uploads/UnitIIIRulesofOrigin.pdf (utilized for Europe's Jean Monnet Program); Centre for International Law, Integration Through Law: The ASEAN Way in a Comparative Context, Chap. 11, *available at* http://cil.nus.edu.sg/wp/wp-content/uploads/2015/04/1-ASEAN-ITL-Policy-Recommendation.pdf (discussing pathways to further integration in Southeast Asia); Prapanpong Khumon, *Rules of Origin for Services in Asia-Pacific Trade Agreements*, 10 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 591 (2015).

U.S. trade policymaking therefore has taken place largely in the absence of scholarly analysis of one of the most important facets of a contemporary trade agreement. As I will highlight below, this has negative consequences. Again, it surfaces doubts over the dominant strategy that underlies the TPP and other mega-RTAs.

2. Additional Analyses and Findings

My analysis of ROOs and their resulting impact proceeds in three steps. Because ROOs are not standardized, any analysis must be conducted in a disaggregated manner at a sector-specific level. Therefore, the first step is to identify the key sectors where such an analysis is warranted. I focus on five key sectors: autos and auto parts, textiles and apparel, footwear, chemicals, and metals.[85]

Second, for each of these sectors, I analyze how the TPP will alter the legal nature of the ROOs applicable to that sector. To do so, I first determine the baseline rules in application today. This requires scrutinizing existing trade agreements between TPP partners as well as customs rules. I then compare the existing rules against the new rules set forth in the TPP, taking note of how the applicable threshold shifts.

Finally, for each sector, I tie the legal analysis together with sector-specific supply chain analysis to analyze how the altered legal rules will affect trade flows. To do so, I first develop a model of the existing supply chain dynamics for firms in that sector. I then analyze how the shift in legal rules will impact the sourcing options available firms seeking to meet their origin requirements. I draw on a variety of sources including industry reports as well as primary analysis of the HS-6 lines relevant for that sector in the UN Comtrade database.

Of the five sectors analyzed, my findings for two sectors – (1) textiles and apparels, and (2) autos and auto parts – prove particularly informative. In both instances, an examination of the TPP's rules of origin suggests that the agreement may have less of a detrimental impact on Chinese trade than the conventional wisdom suggests.

a. Textiles and apparels

Textiles and apparels are widely believed to be an area where China will experience losses as a consequence of the TPP because of the advantages afforded to Vietnam.[86] Indeed, my earlier analysis of the product-specific trade data found these sectors to be ones where Chinese exporters are likely to face the greatest threat. Labor costs are already lower in Vietnam than China. Following the TPP, Vietnamese textile and apparel producers will benefit from tariff-free entry into large consumer retail markets such as the U.S. and Japan, while Chinese exporters will continue to be subject to tariffs

[85] The selected sectors emerge out of my earlier analysis of the product-specific data. They are also in keeping with the selection made by the U.S. ITC of the key sectors affected by the TPP.

[86] Sheng Lu, *Impact of the Trans-Pacific Partnership on China's Textiles and Apparel Exports*, 59 INT'L TRADE J. 19 (2015).

in the range of 8-25%.[87] The expectation therefore is that Vietnamese firms will gain at the expense of Chinese firms.[88]

However, a closer examination of the TPP's rules of origin for textiles raises questions about just how large the negative impact will be for China. Contained within the TPP's chapter for textiles and apparel is a technical annex that sets forth detailed rules of origin for specific textile and apparel products.[89] Among its many requirements is a "yarn forward" rule. This rule stipulates that an apparel or textile qualifies for tariff-free treatment only if the yarn used to make the product is sourced from a TPP country.[90]

This important bit of legal detail may be easily missed in a cursory glance over the TPP. The rule is buried in the tables found in the TPP's Annex 4-A stipulating chapter notes for particular textile and apparel products. Moreover, even if one is aware of the rule, its significance may not be readily apparent. Only if one is familiar with the intricacies of supply chain dynamics for textile and apparel products in Asia can one truly appreciate the rule's significance.

Although Vietnam stands to benefit, an important detail not to be overlooked is the fact that it produces almost no cotton and is therefore heavily reliant on foreign yarn. Today, Vietnamese producers are heavily reliant on imports of cheap Chinese yarn.[91] Following the TPP, some experts expect that Vietnamese producers will shift instead to importing yarn instead from the U.S. or Japan for high-quality yarn, and Malaysia, Mexico, or Peru for lower-cost yarn.[92] If this scenario plays out, then the rules of origin will benefit TPP members and harm the excluded party, China, as the models suggest. Under this scenario, Chinese yarn, textile, and apparel manufacturers all lose out, as the supply chains of producers in TPP markets become more closely integrated with one another.

However, an alternative scenario could emerge instead. To compete, Chinese firms could decide to shift the downstream portions of their supply chain from China to Vietnam. So long as every step in its textile or apparel-making process from the yarn forward is done in Vietnam or another TPP country, products made by the Chinese firm will enjoy tariff-free treatment under the TPP. Such a move therefore would neutralize any advantage to be gained by Vietnamese competitors. Under this scenario, Chinese labor loses out because downstream production will be done in Vietnam rather than China. But Chinese capital will not. Instead, Chinese textile and apparel producers

[87] Calculations based on author's analysis of MFN applied rates for HS-code 61 and 62.

[88] Le Hong Hiep, *The TPP's Impact on Vietnam* 7 (ISEAS Perspective No. 63, 2015)(estimating a doubling of textile exports).

[89] TPP, *supra* note 16, Annex 4-A.

[90] *Id*., Annex 4-A-10 & 4-A-12.

[91] Chris Devonshire-Ellis, *The U.S. TPP "Yarn Forward" Program and Implications for China & Vietnam*, CHINA BRIEFING, Nov. 4, 2015, *available at* http://www.china-briefing.com/news/2015/11/04/the-u-s-tpp-yarn-forward-program-and-implications-for-china-vietnam.html.

[92] *Id*.

could still stand benefit from the TPP on account of lower labor costs and lower tariffs – even though China is excluded from the TPP.

Indeed, there are signs that the second scenario, rather than the first, is playing out. Vietnam's garment and textiles industry today is dominated largely by investments from China and Hong Kong, rather than TPP countries.[93] One example is Texhong, a major Chinese textile company, which announced plans to expand its yarn-manufacturing work in Vietnam.[94] Had the TPP entered into force, an unexpected beneficiary would have been Texhong and the downstream Chinese firms that follow in offshoring production.

Once additional details on supply chains and ROOs are considered, we see how the story is much more complicated. Even in a sector where the trade diversion is expected to be large, Chinese producers can counteract the negative impact of a U.S.-led mega-RTA that excludes China by making rational investments that take advantage of the agreement's ROOs. Again, the TPP poses nowhere close to as large a threat to China as the conventional analysis would have us believe.

b. Autos and Auto Parts

The automotive and auto parts sectors present yet another example of how China could stand to gain from the TPP's rule of origin. In the textile/apparel sector analysis above, for a Chinese firm to capture benefits from a trade agreement in which China is excluded, it needed to offshore production to a TPP country. But this step – which triggers a trade-off between Chinese capital and labor – is not always necessary. In certain instances, the change in the legal rules itself can prove sufficient to benefit an excluded country.

How would this work? Suppose certain countries in a free trade agreement already have a FTA with each other. The new second-generation trade agreement results in a weakening of the rules of origin found in the pre-existing first-generation agreement. This shift toward a lower threshold affords downstream producers with greater flexibility to source more of its upstream inputs from producers outside of the free trade area while still qualifying for tariff-free treatment within the free trade zone. Producers from an excluded country, such as China, rush to fill this void. Even though it is not a party to the new trade agreements, again, firms from the excluded country can benefit – this time, without even engaging in any offshoring.

The TPP's rules of origin for autos and auto parts provide a real-world example of this dynamic at work. In North America, a FTA already exists between TPP countries as a result of NAFTA. Under NAFTA's rules of origin, in order for a car to qualify for

[93] *Foreign Invested Firms Dominate Vietnam's Garment and Textile Industry*, VIETNAM BRIEFING, Aug. 5, 2015, *available at* http://www.vietnam-briefing.com/news/foreign-invested-firms-dominate-vietnams-garment-textile-industry.html/.

[94] Shinya Abe, *Chinese Spinning Company to Expand Vietnam Capacity*, NIKKEI ASIAN REVIEW, Aug. 10, 2015. A driver for this decision was the TPP. *See* Katie Smith, *Texhong Textile Accelerates Vietnam Plans Ahead of TPP*, JUST STYLE, Apr. 1, 2016, *available at* http://www.just-style.com/news/texhong-textile-accelerates-vietnam-plans-ahead-of-tpp_id127552.aspx.

tariff-free treatment, 62.5% of its value content must come from NAFTA countries, calculated using a "net cost" methodology.[95] For most auto parts, the threshold is 60%.[96] Additional legal rules, such a tracing list of inputs that do not qualify, also apply.[97]

With more countries joining the TPP, one might think that the rules of origin would apply an even higher threshold. But because so much of Japanese automakers' supply chain lie outside of TPP countries, Japanese negotiators fought for, and obtained, the opposite. Under TPP, the threshold drops to 45% for autos and to as low as 35% for auto parts.[98] The TPP also allows for alternatives besides the "net cost" methodology.[99] In addition, the TPP eliminates NAFTA's tracing list and includes a list of fourteen transformations that would allow an input to be deemed originating.[100] All of these details again are buried deep within the agreement's annexes.

Under NAFTA, a Ford-built or Toyota-built car in Mexico must source 62.5% of its input from the U.S., Canada, or Mexico in order for the car to be imported tariff-free to the U.S. Under TPP, the threshold drops to 45% while the list of eligible countries expands. Consequently, Ford or Toyota can now source more inputs and auto parts from countries excluded from the trade agreement and still qualify for tariff-free treatment.

The country that would have benefited most from a shift from NAFTA to TPP rules of origin is China. Already, Chinese-made auto parts are an important part of Japanese automakers' global supply chains.[101] They are also making significant inroads in the U.S.[102] The weaker TPP rules of origin will accelerate this trend. The same is likely to hold true of raw material inputs for the auto supply chain, such as steel and aluminum, where the global market is flooded with Chinese products resulting from Chinese overcapacity.[103] Had the TPP come into force, its weaker auto ROOs could have fueled further demand for cheaper Chinese steel and aluminum.

Again, at first glance, the trade liberalization commitments under the TPP appear to be negotiated for the benefit of its participants. Only when delving into the rules of origin and supply chain dynamics of the automotive industry does it become clear how

[95] North America Free Trade Agreement, art. 403(5), U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

[96] *Id*.

[97] *Id*., Annex 403.1.

[98] TPP, *supra* note 16, Annex 3-D, 157-165

[99] *Id*.

[100] *Id*., Annex 3-D, Appendix 1, Table B.

[101] Yoko Kubota & Eric Pfanner, *Japan's Car Makers Embrace Trans-Pacific Partnership*, WALL ST. J., Oct. 6, 2015; Kazunori Takada, *Going Local: Japanese Carmakers Turn to Chinese Parts for China Market*, REUTERS, Apr. 18, 2013; Elizabeth Whitman, *Trans-Pacific Partnership Winners: Toyota, Japanese Automakers Could Still Use Mostly Chinese Car Parts While Enjoying Reduced Tariffs Under TPP*, INT'L BUS. TIMES, Oct. 5, 2015.

[102] Jeff Bennett, *5 Things to Know About the U.S. Auto-Parts Industry*, WALL ST. J., Sept. 18, 2015

[103] Raymond Colitt, *Global Steel Glut Concerns Raised in G-20 Draft Statement*, BLOOMBERG, Sept. 3, 2016 (discussing broader trade tensions resulting from Chinese overcapacity)

a country excluded from the agreement, such as China, nevertheless could stand to benefit, so long as it is already a major player in existing supply chains.

However, despite the inherently legal nature of these rules, engaging in an in-depth examination of the TPP's rules of origin is not the norm in the existing legal scholarship. Because these dynamics and rules differ by industry, the investment necessary to develop this academic expertise is large. Consequently, legal analysis of ROOs tends to fall by the wayside, even as its importance in trade agreements grows.

Therefore, it is not just the economic models that are falling short in their ability to capture the complex nuances of 21st Century trade. The legal analyses of the impact of the non-tariff components of trade agreements are also incomplete. As trade negotiations focus less on tariffs, the substance of trade agreements – totaling over 5,000 pages – becomes much more difficult for non-specialists to assess. Far more attention needs to be paid to the complex, technical legal details buried deep in a trade agreement's annexes.

To date, legal scholars have largely overlooked these details, preferring instead to fixate upon elements such as ISDS. But at the end of the day, the crux of the negotiations themselves is centered on the agreement's rules of origin, not these other elements. Understanding how the ROOs will impact trade is critical for understanding who will gain and lose from a given trade agreement. It falls upon legal scholars to do this job in a much more robust manner than has been the case to date. Otherwise, as the above discussion highlights, trade policy can be guided by incomplete analyses that can lead the overall strategy astray.

C. A Failure to Properly Assess the Political Economy Dynamics of Non-Democratic Regimes

The prior two Sections have identified how incomplete scholarly analysis have led to misguided conclusions about the economic costs to China about being excluded from the TPP. The dominant strategy advanced by the Obama Administration and the TPP's proponents rested on the conclusion that these economic costs were significant enough to alter China's trade policymaking posture. More robust analyses of trade diversion effects and ROOs highlight why this conclusion does not hold true.

However, the economic cost argument is not the only basis for the dominant strategy. Proponents also advanced a second line of argument tied to China's own domestic reform agenda.

To understand this second argument, it is first important to understand the context in which China finds itself today. China is in the midst of a difficult economic transition away from its traditional growth model, which will require a further deepening of economic reformers. However, vested interest groups stand in the way of such reforms, much as they did in the 1990s when Premier Zhu Rongji attempted the last ambitious

overhaul of the Chinese economy.[104] In the late 1990s, Premier Zhu relied upon China's WTO accession as a pretext to enact the necessary reforms.[105] Proponents of the dominant strategy argued that China's current leaders will do likewise with respect to the TPP.[106]

In other words, this second line of argument suggests that had the TPP entered into force and expanded, China's leaders would have eventually come to embrace the agreement's norms because of their own economic reform interests. But is this truly the case? Or does this additional argument for the dominant strategy again rest on shaky analytical foundations?

I contend that the latter is true. Again, scholars have based their conclusions on a rudimentary analysis of China's domestic political economy that fails to take into account the complex nuances of the Chinese Party-state.

1. The Conventional Analysis and its Limits

The existing political economy models for trade policymaking at the domestic level of the two-level game are based primarily on democracies. This sufficed when the dominant trading powers were largely democracies. But that is no longer the case today, especially with the rise of China.

In the immediate aftermath of the collapse of Communism in the Soviet bloc, some academics did attempt to construct political economy models specific to post-Communist transition economies. For example, Timothy Frye and Edward Mansfield suggested that new elites in non-democratic countries with fragmented power will use trade liberalization as a tool to advance their interests.[107] A similar narrative developed about China's WTO accession and its role in advancing interest groups favoring an acceleration of China's economic reform agenda in the late 1990s / early 2000s. However, in the intervening decade, academic work on the political economy of trade policy in non-democracies has largely stopped. Meanwhile, the political economy of such states has evolved, rendering the initial models somewhat outdated.

Consequently, the existing political economy analyses of trade policy for non-democracies fall victim to one of two shortcomings. Either it is filtered through the lens of a now-outdated theory. Or worse yet, the complexities of the domestic political economy are ignored entirely, and the country is simply treated as a unitary actor. In short, scholars are giving short shrift to the domestic interactions that shape trade policy in non-democracies as opposed to democracies.

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[104] Barry Naughton, *China's Economy: Complacency, Crisis & the Challenge of Reform*, 143 DAEDALUS 14 (2014).

[105] Gregory Chow, *Impact of Joining the WTO on China's Economic, Legal and Political Institutions*, 8 PACIFIC ECON. REV. 105 (2003).

[106] *See* Robert Zoellick, *Trade is a National Security Imperative*, WALL ST. J., May 17, 2016; Schott, *supra* note 22 ("Chinese interest in the TPP is driven primarily by how the TPP could complement and reinforce domestic reforms").

[107] *See, e.g.*, Timothy Frye & Edward Mansfield, *Fragmenting Protection: The Political Economy of Trade Policy in the Post-Communist World*, 33 BRIT. J. POL. SCI. 635 (2003).

When it comes to China, a common mistake is to treat internal decision-making in China as a black box, with the leadership intent on promoting economic growth above all in order to justify its continued one-Party rule. If it were truly the case that economic interests always reigned supreme, then several elements of the TPP and other mega-RTAs could serve to advance economic reforms. For example, the current Chinese economic strategy calls for greater reliance on consumption and services to drive economic growth.[108] By lowering market access barriers for many services markets, the TPP would help facilitate this desired transformation of the Chinese economy in several sectors.[109]

Indeed, several Chinese scholars have embraced and perpetuated this point of view.[110] Peking University Professor Wang Yong, for example, argues that the TPP provides an opportunity to force China to deepen its economic reforms, just as WTO accession did previously.[111] A number of other Chinese scholars have emphasized similarly the utility of TPP and other mega-regional trade agreements for domestic reforms.[112] This work, in turn, has sparked several foreign experts to suggest likewise that Chinese leaders may well choose to join the TPP in order to advance their own reform agenda.[113]

Western media outlets have further helped disseminate this belief among the U.S. trade policymaking community.[114] Several reports seized on remarks made by the

[108] China, National People's Congress, Thirteenth Five-Year Plan (2016); *see also* SCOTT KENNEDY & CHRISTOPHER JOHNSON, PERFECTING CHINA, INC. 9 (2016)

[109] *China Belongs in the TPP*, BLOOMBERGVIEW (Oct. 8, 2015).

[110] For a general discussion of this camp, see Zhang Xiaotong, *China's View of the TPP: Take it or Leave It, That is the Question*, 50 INT'L SPECTATOR 111, 113 (2014).

[111] Zhang Yuanan & Chen Lixiong, *Closer Look: How Agreements Like the TPP Press China to Reform*, CAIXIN (Oct. 30, 2015, 5:25 pm), http://english.caixin.com/2013-10-30/100597450.html.

[112] Fan He & Panpan Yang, *China's Role in Asia's Free Trade Agreements*, 2 ASIA & THE PAC. POL'Y STUD. 416, 422 (2015); Edwin Lai Lun-cheung, *TPP Offers Opportunity for China to Accelerate Reforms*, EJINSIGHT (Feb. 10, 2016, 8:00 a.m.) http://www.ejinsight.com/20160210-tpp-offers-opportunity-for-china-to-accelerate-reforms/; Wang Yuzhu, *China and the TPP: Reflections and Responses*, *in* TRADE REGIONALISM IN THE ASIA-PACIFIC: DEVELOPMENTS AND FUTURE CHALLENGES 71, 76 (Sanchita Basu Das & Masahiro Kawai, eds., 2016).

[113] *See, e.g.*, Minyuan Zhao, *TPP Could Either Help China Reform or Dig in Deeper*, N.Y. TIMES (Oct. 7, 2015, 9:37 a.m.), http://www.nytimes.com/roomfordebate/2015/10/06/the-future-of-trans-pacific-trade/tpp-could-either-help-china-reform-or-dig-in-deeper; Amitendu Palit, *TPP and Its Implications for Beijing*, CHINA DAILY, Feb. 24, 2016 ("TPP can help usher in the second phase of domestic reforms in China."); Chi Hung Kwan, *China Seeks to Join the TPP*, REITI (Jan. 8, 2014), http://www.rieti.go.jp/en/china/14010801.html.

[114] *See, e.g.*, Kevin Yao, *China to Study Possibility of Joining U.S.-Led Trade Talks*, REUTERS, May 30, 2013; Dingding Chen, *Not So Fast: The TPP Might Be Good News for China*, THE DIPLOMAT, Oct. 7, 2015; Saibal Dasgupta, *China Edging Closer to Accepting TPP Reality*, VOA (April 22, 2016, 7:34 a.m.), http://www.voanews.com/a/china-edging-closer-to-accepting-tpp-reality/3298082.html.

Ministry of Commerce suggesting that China was closely evaluating the TPP.[115] Others seized upon commentary advanced in official Communist Party publications.[116]

All this has served to reinforce the conventional viewpoint that the TPP and other mega-RTAs can be effective in reinforcing a U.S.-led global trade order because China's leaders will eventually come to see it as in their own interests to converge on the rules and norms propagated by the TPP.[117] But note however that this belief is not rooted in any deep-seated analysis of China's domestic political economy. Instead, it simply relies upon government and Party pronouncements as a proxy.

What is required is a more nuanced analysis of how the political economy of trade policy-making operates in systems that are not governed by liberal democracy or market capitalism.[118] This is not simply a China problem. Among the world's top economies, Russia, Saudi Arabia, Vietnam, and the UAE are all WTO members that fall into such a category.

While robust models exist to explain the political economy of trade in advanced economies, the same is not true of complex authoritarian regimes. Although authoritarian systems may lack robust legislative and electoral mechanisms, they still contain various factional interest groups and complex internal mechanisms for resolving disputes within the ruling class. Yet, there is still a tendency to treat the ruling class as a single unitary actor. By not understanding the domestic-level nuances sufficiently, there is a risk that the analysis of how an authoritarian regime will respond may be inaccurate. This shortcoming may not have been of great worry when democracies dominated trade negotiations. However, with China's rise, it may prove fatal.

2. Additional Analyses and Findings

In previous work, I have discussed the complex, intertwined nature of the Chinese Party-state and its economic actors.[119] Just as is true of democracies, there is a robust political mechanism for how actors with competing interests manage to resolve differences among themselves. Unlike democratic models, however, that mechanism resides not within the government itself, but outside of it, within the Communist Party.

My analysis of how the TPP will affect the domestic level interactions within the Chinese political economy involves mapping the constellation of the TPP's legal

[115] *See, e.g.*, *China to Study Joining TPP*, BANGKOK POST, May 30, 2013; Yao, *supra* note 114; *see also* Donald Gross, *Welcoming China to the Trans-Pacific Partnership*, Huffington Post (July 9, 2013, 11:52 a.m.), http://www.huffingtonpost.com/donald-gross/trans-pacific-partnership-china_b_3562801.html; Hideo Ohashi, *China's External Economic Policy in Shifting Development Pattern*, 11 PUBLIC POLICY REV. 141, 167 (2015).

[116] *See, e.g.*, Ben Blanchard, *China Communist Party Paper Says Country Should Join U.S.-Led Trade Pact*, REUTERS, Oct. 24, 2015; Christian Gomez, *China Seeks to Join Trans-Pacific Partnership*, NEW AMERICAN, Oct. 27, 2015.

[117] However, this may come through other pathways outside of TPP accession. *See, e.g.*, Schott, *supra* note 22.

[118] For an excellent study analyzing these mechanisms for WTO litigation involving China, see Gregory Shaffer & Henry Gao, *China and International Trade* (draft-in-progress).

[119] Mark Wu, *The 'China, Inc.' Challenge to Global Trade Governance*, 57 HARV. INT'L L. J. 261, 263-64 (2016).

provisions onto the various affected interest groups and then examining how their conflicts will play out in this Party-based mechanism. This analysis leads to the overall conclusion that China is unlikely to ever sign on to a U.S.-led mega-RTA, be it the TPP or any future successor, as long as it contains provisions that undermine the Party's security interests. Instead, China will seek to advance its economic reform interests through other international economic policies.

To understand why this is the case, one needs to understand how contentious economic issues are resolved within the Party and how this mechanism has changed in recent years. For most of the reform era (*i.e.* 1978 onwards), economic decisions that pitted interest groups, agencies, Party factions, and other actors against one another were resolved through the Central Leading Group for Financial and Economic Affairs.[120] This is an inner group of the Communist Party's Central Committee charged with overseeing the economic policies of the Party-state. This group is composed largely of economic officials, such as the head of the National Development and Reform Commission (NDRC), Minister of Finance, and central bank governor.[121] Consequently, economic interests often did prevail, but it is important to note that even under this structure, the military and information minister both served as checks within the group.

This mechanism applied when the Chinese leadership made a series of difficult decisions concerning China's WTO accession in the late 1990s. However, it is no longer what prevails today. At the Communist Party's Third Plenum in 2013, this process was overhauled with important consequences for economic decision-making.[122] The internal political dynamics of WTO accession era of the late 1990s no longer apply.

While the previous group remains intact, in 2013, the Party migrated many of the critical decisions surrounding economic reform over to a new Central Leading Group for Comprehensively Deepening Reforms.[123] Its composition, however, is vastly different than that of the other group. Among economic officials, only the central bank governor serves in both groups. For a decision-making body focused supposedly on economic reform, the membership is dominated by Party officials not associated with the ministries that run the Chinese economy day-to-day. It includes the vice chairman of the Central Military Commission, the head of the Party Propaganda Department, the Minister of Public Security, the Procurator General, and the head of the State Ethnic Affairs Commission.[124]

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[120] Alice Miller, *The CCP Central Committee's Leading Small Group* 13-14 (China Leadership Monitor No. 26, 2008).

[121] For a full membership list, see *id.*

[122] Chris Buckley, *Chinese Leader Gets More Sway On the Economy and Security*, N.Y. TIMES, Nov. 12, 2013.

[123] This leading group now presides over several of the former leading groups. *See* Alice Miller, *More Already on the Central Committee Leading Small Groups* 6 (China Leadership Monitor no. 44, 2014).

[124] Central Leading Group for Comprehensively Deepening Reform (中央全面深化改革领导小组), BAIDU BAIKE, http://baike.baidu.com/view/11416257.htm?fromtitle=%E4%B8%AD%E5%A4%AE%E5%85%A8%E9%9D%A

Two other additional leading groups were also created at the Third Plenum – a National Security Committee and a Central Leading Group for Internet Security & Informatization.[125] Both groups again include officials from the military as well as the Party and governmental apparatus controlling information. Noticeably absent from any of these leading groups is the Minister of Commerce. This signifies a stark contrast with the political economy of most countries where the trade minister is generally at the center of the coordination process.

What this analysis of the Chinese political economy signifies is that the belief that economic interests will always trump is incorrect. This may have been the case of the earlier era. But it is no longer true today. Instead, the overhaul of the intra-Party processes has resulted in a carefully-constructed mechanism with multiple checkpoints to ensure that any economic reform policies will not harm the Party's security interests. In other words, simply because a trade agreement will bolster the Party's economic reform agenda does not mean it will not be adopted. Instead, to pass muster, it must not threaten the Party's control over information flows, vital economic infrastructure, or national security apparatus.

Therefore, the conventional belief that China will adopt the TPP to bolster economic reforms, as it did with its WTO accession, is naïve and incorrect. The political economy of trade in China of the mid-2010s is dramatically different than that of the late 1990s, in large part due to shifts engineered by President Xi Jinping. Whether reformers will be permitted to use the TPP to spur further economic reforms will turn on how the TPP affects the Party's security and other non-trade interests.

To analyze the TPP's potential impact, I disaggregate the agreement key provisions and examine which ones will raise the ire of important constituencies, especially those serving on the various leading groups tasked with overseeing economic reform. My findings reveal that several provisions are likely to encounter pushback, including those concerning government procurement, competition policy, labor rights, and the side agreement on exchange rates. Several involve the disclosure of potentially sensitive information which the government may not wish to reveal; others involve changes to government practices to which China has been reluctant to embrace.

Most importantly, two sets of requirements within the TPP will likely prove unacceptable within China's current political economy. The first set concerns information flows and data control over the internet. The TPP requires that countries allow for the free flow of information across borders for the conduct of business, subject to certain exceptions.[126] It also prohibits localization requirements[127] and bars governments from mandating that companies disclose their source code.[128] These TPP

2%E6%B7%B1%E5%8C%96%E6%94%B9%E9%9D%A9%E9%A2%86%E5%AF%BC%E5%B0%8F%E7%BB%84&fromid=12424995&type=syn (last visited Jan. 20, 2017).

[125] Buckley, *supra* note 122; Miller, *supra* note 123, at 6.

[126] TPP, *supra* note 16, art. 14.11.

[127] *Id*., art. 14.13.

[128] *Id*., art. 14.17.

requirements cut squarely against the Party's desire to keep a tight lid on information flows and monitor internet-related activities.

The second set of requirements concern state-owned enterprises (SOEs). The TPP includes several requirements, including one that non-commercial assistance not adversely affect competition.[129] These requirements seek to rein in a number of practices used by China to advantage its exporters and producers, including favorable access to capital and raw materials, preferential rates for energy inputs, and favorable regulatory treatment. Although the Party itself seeks to enact further SOE reforms, many of these provisions go well beyond the range of reforms being sought. For national security as well as industrial policy purposes, stakeholders will seek to retain this policy flexibility.

TPP members made clear that these provisions are non-severable, meaning that any acceding member must accept the general contours of the agreement as a whole package.[130] Given internal sensitivities and the altered political economy, it is highly unlikely that even had the TPP prevailed, China's Communist Party would have embraced it to bolster economic reforms, as it did with WTO accession.

Instead, as several other scholars have pointed out, China will likely turn to other strategies to advance its geo-economic and reform interests.[131] These include not only RCEP, but also the "One Belt, One Road" initiative. These alternatives will have a much easier time sailing through the Party's decision-making checkpoints than the TPP.

The failure to engage in an extensive analysis of China's domestic political economy gives rise to the false belief that China will eventually seek to join the TPP, if enacted, or at least embrace its norms, because it is beneficial to China's own economic reform priorities. This is simply not true. China and its political economy have evolved significantly since China acceded to the WTO. TPP is not WTO accession redux. Instead, any attempt to embrace it will encounter significant political headwinds.[132] As long as the current governance structure remains in place, China is unlikely to sign on to a U.S.-led mega-RTA initiative such as the TPP.

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Part II has sought to debunk the conventional wisdom that the U.S. could successfully execute the strategy of using thick mega-RTAs as building blocks to pressure recalcitrant players to accept new liberal internationalist trade rules of its

[129] *Id*., chap. 17.

[130] *Id*., art. 30.4.

[131] *See, e.g.*, Inu Barbee & Simon Lester, *The TPP and the Future of Trade Agreements*, 2 LAT. AM. J. INT'L TRADE L. 207, 221-222 (2014); Bryan Mercurio, *The Flow-On Effect*, *in* EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 515 (M. Bungenberg et al., eds., 2016); Barry Naughton et al., *What Will the TPP Mean for China?* FOREIGN POLICY, Oct. 7, 2015 (comments by Arthur Kroeber); Zhang, *supra* note 110, at 115-116; Min Ye, *China and Competing Cooperation in Asia-Pacific*, 11 ASIA SEC. 206 (2015).

[132] *Accord* Mercurio, *supra* note 131, at 518-519.

making. Although the U.S. and its allies collectively are still, far and away, the biggest economies in the world today, the world has altered dramatically since the late 1990s.

Technological innovation has fueled the massive disaggregation of production, leading to much more complex value chains that span multiple borders than those which existed in the 1990s. No longer is it so easy to craft a trade agreement that benefits primarily producers in one country at the expense of another, except for commodities. The Great Unbundling, in turn, has fueled the economic re-emergence of China. Although the Chinese economy may face structural problems, China has already achieved a level of economic power that surpasses that of any recent U.S. rival. It is already the world's largest trading country, the world's largest consumer market, and the primary driver of global growth since the Great Recession. Moreover, unlike Japan, China is not dependent on the U.S. for security or other forms of non-trade assistance. Consequently, the U.S. and the West no longer possesses as much relative geopolitical power as it had in the immediate aftermath of the Cold War.

Against this backdrop, the utility of mega-RTAs as a source of leverage is limited. Part II has demonstrated how China already possesses several instruments to disarm U.S.-led efforts to pressure it to accept new trade rules. First, it can counter with trade initiatives of its own, so as to neutralize any competitive trade threats that arise out of the TPP or other U.S.-led mega-RTAs. Already, the U.S. is unable to exert pressure on its allies to shy away from Chinese-led initiatives. Second, even if the Chinese-led trade initiatives fail, China can still take advantage of existing low tariff rates for higher-value-added technology exports to push forward on its trade and industrial policy strategy. Mega-RTAs alone serve to effectuate trade diversion threats in mainly "sunset" industries from which China is already seeking to transition away. Finally, Chinese firms have multiple options to exploit the ROOs embedded within the RTAs to achieve gains of their own from U.S.-led trade liberalization initiatives, even if China remains officially on the outside.

So far, among emerging economies, it may only be China that has this broad a set of capabilities to counter a U.S. or Western-led trade strategy. But China is offering a template for other developing countries to copy. More importantly, China's intransigence, by itself, will be sufficient to stifle efforts to update global trade rules. The era when RTAs could serve as a "building block" on the road toward developing new multilateral rules has ended.

III. RETHINKING THE RATIONALE FOR MEGA-RTAS

[Note: The full text of Part III is not included with this draft. However, it touches upon reasons why Western countries may nevertheless still consider negotiating mega-RTAs, but with a more clear-headed vision of what they are bound to accomplish. These include:

- Pre-emptive move to defend against competing rules being set in its stead
- Prevention of other countries from implementing economic structures & quasi-mercantilist strategies akin to "China, Inc."
- Raising the importance of a given issue within a trading partner, which can then engage in a FTA with a third party in setting rules for that issue]

CONCLUSION

We stand at the dawn of a new era for trade governance. The days when Western economic powers, because of their sheer economic heft, could craft new rules in thick trade agreements among themselves and cajole the rest of the world to accept them has ended. In the coming decades, the two largest trading powers – U.S. and China – will both lack the economic power to bend the other toward its vision of global governance. Remaining wedded to a mega-RTA strategy to outflank and apply leverage on China is a misguided approach as far as the coming era is concerned.

This means that the solution to America's (and by extension, the West's) existing trade woes lie beyond simply seeking to enact a series of broader redistribution policies and making tweaks to mega-RTAs to secure broader popular buy-in. For those committed to a rules-based global trading system, a broader strategy rethink is required. Simply hoping to wait out the Trump Administration and then resurrect the prior strategy is not the answer.

The above analysis, therefore, should reshape our understanding of the costs associated with the Trump Administration's decision to abandon the TPP. Much has been made about this decision being costly from a geostrategic standpoint.[133] In particular, some fear that the U.S. may have foolishly chosen to unilaterally abdicate its leadership in shaping global trade rules, effectively ceding influence to a rising China.[134] Certainly, the decision to abandon the TPP has geopolitical consequences. It damages America's negotiating credibility. America's Asian allies will seek reassurance that the U.S. remains committed to deep integration with the region, not just militarily but also economically.

But as far as America's rivalry with China for global economic leadership is concerned, the consequences of TPP's demise are not nearly as dire as some may fear. Even had the TPP been ratified, it would not have succeeded in pressuring China to adopt a posture more beneficial to the U.S. The coming era of globalization requires Americans to accept an altered reality. No matter how much Americans may hope

[133] Huileng Tan, *The US Will Have Zero Credibility in Asia if TPP Fails, Ex-CIA Official Warns*, CNBC, Sept. 11, 2016; Michael Froman, USTR, Remarks at Rice University's Baker Institute for Public Policy, Sept. 19, 2016; David Roman, *Singapore Warns U.S. Credibility on Line Over Trade Pact*, BLOOMBERG, Aug. 2, 2016.

[134] *A Retreat From TPP Would Empower China*, N.Y. TIMES, Nov. 21, 2016; Simon Denyer & Anna Fifield, *China is the Big Winner as Clinton, Trump Disavow Hard-Fought Asia-Pacific Trade Deal*, WASH. POST, Oct. 20, 2016; *Trump's TPP Withdrawal Gives China Chance to Redraw Trade Map*, GUARDIAN, Nov. 24, 2016.

otherwise, the old post-war trade order – where the U.S. and other advanced economies led in the periodic updating of multilateral rules that are eventually embraced by all – has come to an end. The liberal internationalist dream has reached its limits, at least for now. A new mode of global trade rule-making will be required.

At the international level, China's rise and its deep integration into global value chains in the past fifteen years is a significant game-changer. For the first time since Bretton Woods, the world's largest trading power is a country that neither shares the West's political values nor its economic ideology. Although its economic weight is nowhere as large as the West's collectively, its power is already sufficient to withstand any attempt to exclude it from future rule-making. Consequently, the U.S. and its Western allies must learn to find ways to jointly cooperate with China to update trade rules, while not compromising core values.

The right approach for the coming era is a multi-prong strategy where we cooperate in forging issue-specific plurilateral agreements at the WTO multilateral level, while also deepening integration with allies through bilateral or regional agreements that are more limited in scope than the proposed mega-RTAs. Furthermore, the latter ought to be tailored to fit the circumstances rather than viewed as a comprehensive "building block" template for future multilateral rules. Finally, greater cooperation is required outside of the WTO regime to tackle other negative consequences of globalization such as tax evasion.

In short, the trade policy that worked for the latter half of the Twentieth Century no longer works today. Large-scale, deep-integration trade agreements built around the "single undertaking" model are no longer the right answer. The overall trade strategy requires a major reset, and the policymaking apparatus requires a major upgrade. The stakes are large. How America and its Western allies handles this inflection point will decide not only if a rules-based trading system can persevere, but whether the West will prosper or decline as globalization inevitably advances.