

# *China and the Evolving Geo-Economics: Preparing for a new trade and investment regime*

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## *Introducing the issue*

We live in a rapidly changing world with evolving technologies, production systems, business models, and an increasing number of developing economies that are becoming more important in the world economy. In today's significantly *interconnected* world, both external and internal conditions affect the success of a nation's domestic performance and sustained ability to meet key economic and social objectives. Thus, even domestic policy requires bearing in mind the evolution of geo-economics in the world today. We need to better understand the factors that contribute to these changes, such as:

- The world is increasingly multi-polar, as a number of developing economies have significantly enhanced their economic presence in every continent.
- Supply chains and trade in tasks are now significantly important for international trade.
- New sources of foreign direct investment are increasing global links.
- Mega-free trade areas (mega-FTAs) are being negotiated that would create new disciplines for trade and investment regulation.
- The large expected growth of the middle class will affect the demand and requirement for natural resources.
- As the external demand for natural resources increases and growth in the region gains momentum, Africa's importance in trade and investment will become stronger than ever.
- China's perception of the role it needs to play is changing in order to help sustain the harmonious growing global markets that are important for its own domestic objectives.
- United States will respond to these developments.

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<sup>1</sup> This brief is based on the 20th Lovraj Kumar Memorial Lecture that given by the author on October 4, 2013, in New Delhi, and an article that was recently published in an Indian think-piece magazine called *Hard News*.

- Factors such as demographics and technology-related changes reduce communications costs, improve the possibility of timely response, produce new combinations of goods and services, and create novel synergies and competition.

Two of the above-mentioned factors are particularly important to show us the way forward for appropriate trade policy response: the mega-FTA negotiations and the policy changes being adopted by China.

## Mega-FTA Negotiations

The large free trade agreement negotiations deal, with established issues as well as new ones, reflects major changes arising due to changes in technology and patterns of trade. As Jayanta Roy, a former Economic Advisor to India's Commerce Ministry, summarizes in a recent article:

*Trade and investment in today's world takes place in an environment defined by highly integrated global production networks. Trade in intangibles as defined by management of knowledge, data, and support services (IT and ITES) is becoming increasingly more important. The impending automation of many manufacturing and services functions is already starting to re-define the relationship between labor and capital. Such drastic changes require a highly efficient trade and investment environment (low transaction costs), and strategic thinking from the policy-makers who manage this relationship.<sup>2</sup>*

An important example of mega-FTA negotiations is the Trans Pacific Partnership (TPP). In addition to greater market access, the TPP's areas of negotiations include intellectual property rights, foreign investment, competition policy, environment, labour, state-owned enterprises, e-commerce, competitiveness and supply chains, government procurement, technical barriers to trade, transparency in health care technology and pharmaceuticals, and regulatory coherence. Those who have been following the discussions in the World Trade Organization (WTO) Doha Round will see that this list extends the scope and content of issues addressed by emerging economies in their negotiating agenda.

An important feature of these topics is that many of them are usually addressed through technical or other standards. If mega-FTAs such as the TPP are able to devise the basis for standards within their framework, then they will *in effect* define such standards for much of international trade. The impact of the result is likely to be large because it would also be reflected in the Transatlantic Trade and Investment Partnership (TTIP), the ongoing negotiations between the United States and the European Union.

It is noteworthy that a large number of economies, including Brazil, Russia, India and China (BRIC), are not participants in the TPP or TTIP. Though there are different views on the extent and nature of success of the TPP, considering the trade-related discussions and focus until now (including in G-20), it is likely that the TPP will succeed in higher trade-related standards in a number of areas, including environmental issues, labour, state enterprise reform, investment and intellectual property. Moreover, such results may be achieved in a relatively short time period—within an outer limit of three to five years.

An interesting result for environment, labour and investment would be that they effectively apply not just to specific product areas, but to the economy as a whole. Those unable to meet the new higher standards would find it difficult

<sup>2</sup> J. Roy, (2013, September 21). New institutional framework for India's trade reforms. *Business Standard*. Retrieved from [http://www.business-standard.com/article/opinion/jayanta-roy-new-institutional-framework-for-india-s-trade-reforms-113092100608\\_1.html](http://www.business-standard.com/article/opinion/jayanta-roy-new-institutional-framework-for-india-s-trade-reforms-113092100608_1.html)

to successfully access the markets of TPP and TTIP nations, which account for a substantial part of global exports. In the present interconnected world, being excluded from a large part of the global market would significantly limit the opportunities available to a nation. This is why China has already begun to prepare for such changes, and others should also take note.

## Likely Changes in China's Interaction with Ongoing Plurilaterals

For China's sustained growth over time, its policy-makers place major importance on the harmonious growth of global markets with non-discriminatory access for trade and outward investment for China. Thus, any reform agenda of China would aim to enable the nation to actively participate in a trade and investment regime arising from the mega-FTAs such as TPP.

China's programs include structural reforms to strengthen the foundations for a market-based economy, accelerate the pace of innovation and create an open innovation system, emphasize green economy, improve environmental standards, enhance the efficiency of the services sector (with an important emphasis on producer services) and reform state enterprise. It also promotes policy reform in its foreign investment regime so as to attract "higher value or better quality" investments into the country and get better treatment for its own outward foreign direct investment. Attracting higher-value investments also implies improving the intellectual property rights regime.

Such a focus is also reflected in China deciding to negotiate bilateral investment treaties with the United States and the European Union. China and the United States have agreed on a non-binding climate plan; China has asked to be admitted as one of the parties negotiating the plurilateral Trade in Service Agreement (TISA). There is also a change, though subtle, in its position on some issues in the WTO, showing greater ambition in certain areas. Reportedly, China is even considering participating in the TPP negotiations: when China's President Xi Jinping met President Obama, he asked to be kept informed about TPP negotiations. China could apply to be part of the TPP at a later date, or, if not a part of the mega-FTA, it could still prepare its business to meet the standards and disciplines resulting from these negotiations to have easier access to the large market covered by these plurilateral negotiations.

These developments can potentially change China's interactions with the rest of the world in the context of trade negotiations involving developed or developing nations. In a world with growing international supply chains and China's significant role in the evolving patterns of world trade and investment relationships, if China's policies are not in consonance with the new trade and investment regulations, the mega-FTAs would mean cost increases and rising trade disruptions. Though China's policy reform will mitigate such concerns, the large number of countries outside mega-FTAs would need to make major preparations to maintain or enhance their economic opportunities.

Of the total world trade, the share of TPP partners, the European Union and China is about two thirds. Standards are usually applied similarly across total trade, that is to say, with trade agreement participants as well as others. If China applies the same standards as in the countries covered by the TPP and TTIP, these higher standards would de facto apply to nearly two thirds of world trade. This has major implications for most nations in the world, and these impacts could be felt in the next three to five years.

Yet another concern is that limited initiatives such as mega-FTAs tend to create exclusionary systems because the primary focus of participants is on themselves. This decade, the ongoing growth of the middle class will mean an immense increase in raw material demand. The consequent importance of Africa in global trade transactions means

that the African nations that are currently excluded from the large mega-FTA initiatives will be in a strong position to press their demand for more inclusive agreements that represent their concerns and aspirations. The likely conflict that will arise can be resolved only through inclusive trade regimes such as the WTO. Thus, diplomatic and technical strategies will be needed to create a transition from limited membership agreements to the WTO regime. The recent success at the WTO Bali ministerial meeting, though small, has reinvigorated the multilateral process. As U.S. Trade Representative Michael Froman remarked at Bali, “the WTO has entered a new era.” In this situation, a focus on transition from plurilateral to multilateral processes should become an important part of the work on evolving global trade and investment regimes.

Thus, with such likely changes in geo-economics, all nations will need to understand the developments and make necessary adjustments and preparations, including augmenting their capacities to meet new standards and to create inclusive conditions for trade and investment. The time to determine and implement the response is *now*, not when opportunities start being adversely affected by the changed conditions, leaving little time available for reacting appropriately.

Published by the International Institute for Sustainable Development.

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