

October 25, 2021

Here Comes China!

Following President Donald Trump's withdrawal from the Transpacific Partnership (TPP) in January 2017, it was believed that the agreement would die a quiet death. However, with the leadership of Japan and Australia, the agreement found new life and the remaining members decided to move forward with the deal. Although the new agreement [removed 22 clauses](#) from the original pact, it remains largely intact. Now rebranded as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the deal has been in place since December 2018. Following its signing, it has been able to attract new applicants from the United Kingdom, Taiwan, and China. There is also growing interest from [South Korea and Thailand](#).

Serving as the current chair of the pact, Japan has openly [advocated for the inclusion of Taiwan](#). If admitted, this would be the first time Taiwan has joined a multilateral trade agreement independent of China. Such a move would be a direct rebuke of the One China Principle, which states that Taiwan is an inalienable part of the People's Republic of China that will eventually be reunified. In response, China has come out against Taiwan's inclusion in CPTPP. In this report, we argue that Taiwan may have influenced China's decision to formally apply to CPTPP, and we discuss what Chinese membership in the group could mean for the global economy. We begin with a discussion on the history of Taiwan and the One China Policy, which holds that there is only one Chinese government, and its capital is

Beijing. Next, we will discuss the motivations for CPTPP and why it is important. Finally, we will discuss Taiwan's and China's chances of being admitted into the group. As usual, we will conclude with market ramifications.

One China Policy

There are many theories as to why China decided to join CPTPP. One theory holds that China applied to cement its dominance throughout the Pacific region, especially in light of the U.S. withdrawal from TPP. Another theory suggests China applied in response to the U.S. and the U.K. agreeing to supply Australia with nuclear submarines. However, the timing and circumstance of China's application suggest that it may have been done to maintain the One China Principle.

Due to China's history of minimizing Taiwan's presence on the international stage, we suspect that Beijing applied because it believed Taiwan planned to do so imminently. Had Taiwan applied first, it would have supported the idea that the island is independent of China. After Taiwan submitted its bid to join the pact, China stated that it [opposed any official interaction with Taiwan and CPTPP](#). Beijing's insistence that Taipei not engage in any official trade discussions is rooted in how the two regions became separated. The official stances from both Taiwan and the mainland are that each represents "China."

Following the end of the Chinese Civil War, the Chinese Nationalists that fled to Taiwan declared the capital of the Republic of China to be Taipei, while the Communists that remained on mainland China declared the

capital of the People's Republic of China to be Beijing. However, this sentiment has changed over the last few years. Thirty years ago, only 13% of Taiwanese people considered themselves to be non-Chinese, whereas today it is around 83%. The change in identity has led to a growing push within Taiwan for the island to declare itself independent of China. Taiwanese President Tsai Ing-wen mirrored this sentiment when she stated [that she does not need to formally declare Taiwan's independence](#), because it is already independent. The push for Taiwan independence has caused growing friction between Beijing and Taipei.

The U.S. has done little to disrupt this status quo. In order to build a closer relationship with China, the U.S. has consistently maintained the One China Policy. Not to be confused with the One China Principle, the One China Policy holds that there is only one Chinese government, and its capital is Beijing. As part of the agreement, the U.S. had to recognize Beijing as the capital of China and withdrew its diplomats from Taipei. Additionally, the U.S. agreed to stay out of the dispute between China and Taiwan regarding the matter of reunification as long as the sides remained peaceful. However, this agreement became more vague as the U.S. has transitioned from friend to adversary.

With the U.S. backing of the One China Policy, China was able to compel countries around the world to accept Beijing as the sole capital of China. Until recently, China has been successful in forcing most countries to not recognize Taiwan as an independent country without much issue. It has done so by requiring all countries to break formal ties with Taiwan as a precondition of establishing trade relations with China. For countries looking for growth, the size and scope of the Chinese

economy make it a very attractive place to do business. As a result, it is difficult for most countries to deny Beijing's pressure. Thus, Taiwan has struggled to gain diplomatic recognition. With the exception of a few bilateral trade agreements, it has largely been frozen out of any trade arrangement that does not include China.

From TPP to CPTPP

When the United States agreed to join a trade agreement with a small group of Pacific Rim countries, its goal was to force China to adopt a preferred U.S. trade policy. Started in 2005, the original deal was merely a free trade agreement between Brunei, Chile, New Zealand, and Singapore. It was the first free-trade agreement linking Asia, the Pacific, and Latin America. The focus of the agreement was to eliminate trade barriers and to ensure fair treatment and non-discrimination of new services. Inspired by the agreement's goal, the U.S. joined negotiations in 2008 with the hope that the agreement would be used as an outline for trade throughout the Indo-Pacific region. After Mexico and Canada joined, the agreement emerged as one of the largest free trade deals in the world including 12 countries and [accounting for around 40% of GDP](#). Even after the U.S. withdrawal, the deal has been able to attract other countries to join, which has clearly caught the attention of Beijing.

One of the motivations for TPP was to fill the holes left open by the World Trade Organization (WTO). Since its inception in 1995, the trade body has not been able to update its rules to keep up with changes in the global economy. As a result, developing countries, particularly China, have been able to exploit these rules to promote their respective exports through unfair trade practices. The U.S. has been particularly vocal about these abuses. [In a recent WTO](#)

[review](#), the U.S. alleged that China gives preferential treatment to state-owned enterprises, implements data restrictions, has inadequate enforcement of intellectual property rights, and allows for cyber theft. These complaints are not new, as countries have lobbed them at China for decades. However, the WTO's inability or unwillingness to discipline China has undermined its legitimacy. As a result, the U.S. has sought ways to circumvent the WTO in order to address its grievances. One such way the U.S. has gone around the WTO is by imposing trade tariffs on Chinese goods despite the WTO's ruling against them.

CPTPP addresses many of the issues raised by countries that have gone unacknowledged by the WTO by offering more trade access among its partners in exchange for tighter restrictions on state support, tougher labor laws, and stronger intellectual property enforcement. Hence, assuming China would be willing to abide by the group's rules, its admission would have achieved the long-run goal of the U.S. to curb China's trade abuses. However, this is easier said than done.

Chances of Admission

The bids from both China and Taiwan have given members of the partnership a difficult choice to make. They can decide to admit both, one, or neither. No matter what, each country needs unanimous support from members of CPTPP in order to be admitted. This could be difficult as Beijing and Taipei have created a divide between members, with Southeast Asian countries in favor of admitting China, while U.S. allied countries such as Canada, Japan, and Australia are in favor of admitting Taiwan.

China's tendency to weaponize its markets has led many countries to assume that it is

an unreliable trade partner. In response to the arrest of Huawei executive Meng Wanzhou in Vancouver, China banned several Canadian exports, including [canola oil, beef, and pork](#). Additionally, Australia faced trade restrictions after it condemned China for its treatment of Uyghurs in Xinjiang and pressed for an international investigation into the origins of COVID-19. China's tendency to take trade action against any country that acts against it is one of the reasons members decided to join the pact. As a result, including China could undermine efforts to establish a counterweight to Beijing's growing influence in the Indo-Pacific. Moreover, China's pattern of disregarding WTO rules likely suggests that it may not follow the rules established by the pact. Hence, admitting China could undermine the partnership's credibility.

Moreover, China will likely find it difficult to overcome the U.S. influence. Although the U.S. withdrew from the partnership in 2017, the United States–Mexico–Canada Agreement (USMCA) included most of the agreement from TPP. One study showed that [57% of the USMCA agreement came from TPP](#). As part of the agreement, the countries agreed that they would inform the trade group if they join a new free-trade agreement. It also gives countries the ability to leave the USMCA for any reason they choose. Hence, China's admission into CPTPP could possibly trigger a U.S. withdrawal from USMCA or a renegotiation of the agreement. Given that the U.S. is the largest trading partner for both Canada and Mexico, it is very unlikely that either member would be willing to risk enraging the U.S. by admitting China.

That being said, China's economic clout will be difficult to ignore for most members of CPTPP. With the exception of Mexico and

Canada, China is the bloc's biggest importer. Therefore, it will be problematic for countries to ignore China's request. Additionally, many of these groups have already signed on to join the China-led trade group called the Regional Comprehensive Economic Partnership (RCEP), making it challenging for those same countries to justify rejecting China for CPTPP. Lastly, countries that reject China but admit Taiwan will likely be subject to trade retaliation from China, something every country within the group would like to avoid.

Ramifications

Although China's trade practices and foreign policy have stirred up international resentment, its markets are just too attractive for countries to risk getting on its bad side. Additionally, Indo-Pacific countries still like the U.S. and rely on it for security. As a

result, we suspect that both China's and Taiwan's applications will likely either be jointly accepted or jointly denied by the group, with the latter being the most likely outcome. However, this situation does show that the threat of including Taiwan in a free-trade agreement could be used as a bargaining chip to bring China to the negotiating table. If the U.S. is able to rejoin CPTPP, which we think is unlikely but not impossible, we expect it will have the leverage to force China to fix some of its trade practices. The tougher regulations on China could make equities in emerging markets like Mexico more attractive as they will likely lead to some trade divergence away from China.

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October 25, 2021

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