



# TRADE AND DEVELOPMENT SYMPOSIUM

## Perspectives on the Multilateral Trading System

A Collection of Short Essays

# The Trans-Pacific Partnership

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## Introduction

President Barack Obama is not known as a champion of globalization. For years, the Colombia, Panama and Peru Free Trade Agreements were unwelcome guests in the Obama White House, while the Doha Development Round was locked in a closet. Yet, as he nears the end of his first (and perhaps only) term in office, the Trans-Pacific Partnership (TPP) has become Obama's signature initiative in Asia. Why? The answer mixes high diplomacy and mundane economics.

TPP talks were launched without fanfare by former President George W. Bush in March 2008, but it was President Obama who, in November 2009, committed the United States to work with the so-called P4 countries to create "a regional agreement that will have broad-based membership and the high standards worthy of a 21st century trade agreement."<sup>2</sup> The following year President Obama put forth an ambitious goal: finishing negotiations by November 2011, in time for the Honolulu summit of the Asia Pacific Economic Cooperation Forum (APEC).

So why is President Obama putting so much effort into an agreement where current members represent a meager 5 percent of total US merchandise trade? Three answers: China, China, China. China's rapid growth has fostered an assertive geo-strategic behavior marked by claims in the South and East China seas, continued support of North Korea, and modest steps toward a blue water navy. On the economic side, China's burst as the world's assembly plant has challenged US and other manufacturing producers around the world. Meanwhile, Asia generally, and China especially, promise to be the world's growth pole for the next twenty years. The United States does not want to be disadvantaged in this booming market.

Against this backdrop, the TPP has become Obama's chosen vehicle to strengthen the US political-economic footprint in Asia. Foremost, the high standards of liberalization envisaged in the TPP template - if adopted across Asia, including China - will entrench market practices and precepts in the world's most dynamic region. Moreover, if the TPP agreement is successfully concluded and extended to a good chunk of Asia, it will stimulate trade and investment to the advantage of all parties. However the current cluster of TPP countries surrounding the United States is too small to deliver much bang. To make a significant impact, politically and economically, the TPP must expand its founding membership to include large regional players, notably Japan and Korea in Asia, and Canada and Mexico in North America.

## State of Play

Today, the United States has trade agreements with only three Asian-Pacific economies -- Australia, Singapore and Korea. China, by contrast, has trade agreements with Hong Kong, Macao, ASEAN, New Zealand and Singapore, and is preparing to engage in talks with India, Japan and Korea. The scorecard says it all: the United States is far behind in commercial diplomacy. The best path forward is an expanded TPP.

2 The P4 countries are Brunei, Chile, New Zealand and Singapore. President Obama's speech was delivered at Suntory Hall, Tokyo, Japan. November 14, 2009

3 President Hu Jintao's remarks at the anniversary celebrations for the founding of the People's Liberation Army Navy, Qingdao, China. April 2009. Available at <http://www.reuters.com/article/2009/04/23/us-china-navy-sb-idUSTRE53M36R20090423>.

The current TPP roster includes Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam. These countries have a combined GDP of \$17 trillion, about a quarter of world GDP; but excluding the United States, aggregate GDP totals \$2 trillion, only 3 percent of world output. A similar story can be seen in trade. Trade in goods and services (exports plus imports) of the TPP participants total \$7 trillion; excluding the US cuts the figure by two-thirds. The agreement needs big players like Japan and Korea to make TPP a credible Asian force, and it needs Canada and Mexico to live up to the name of Trans-Pacific Partnership. Adding these four countries would boost the combined GDP by \$9 trillion and total trade by \$4 trillion.

Adding Japan and Korea to the agreement would pose a watershed moment in Asian regional architecture. The choice would be clear: the Asia-only integration model now growing around China versus the more inclusive Asia-Pacific model contemplated by TPP. In fact the TPP envisages an eventual Free Trade Agreement of the Asia-Pacific (FTAAP), including China and all of ASEAN. The FTAAP, created this way, would forge trans-Pacific commercial links on terms agreeable to the United States and its Asian allies who worry about China's state-centered and mercantilistic economic model. China's trade surplus was not significant in the 1990s, and amounted to just \$25 billion in 2003, but may be close to \$200 billion in 2011. Continued growth along this path will cause serious macroeconomic problems in a number of countries, not only the United States.

Economic concerns are augmented by security fears. Territorial disputes over the South China Sea frighten claimants that lack the military muscle to stand up to China - Brunei, Malaysia, Philippines, Taiwan and Vietnam. China's continued support of North Korea, partly to forestall unification, irritates South Korea. China's naval expansion towards blue water capability is another worry. The leadership has declared that China "will stick unswervingly to the path of peaceful development, and will never seek hegemony now or in the future".<sup>3</sup> But China's construction of an aircraft carrier and its partnership with Pakistan to access ports in the Indian Ocean may create capabilities that could support bolder intentions.

Of course the TPP cannot, by itself, put to rest the range of political and economic challenges which inevitably accompany China's rise as a world power. But at this juncture, the TPP looks like a critical component of a broader US strategy.

## Elements of the TPP Package

Three main elements constitute the TPP package: first the substantive chapters that launch the agreement and establish a template for new adherents; second the timeline for translating talk into a trade pact; and third the path towards broader regional integration.

### 1. Substantive chapters

Nearly all the substantive chapters will be the object of intense negotiation. Here we single out just a few contentious areas.

## Services and investment

Key areas for service and investment liberalization are finance, telecommunications, and E-commerce. The United States will push for GATS-plus market access for financial firms, including the right to establish a commercial presence, 100 percent ownership, and cross-border delivery without a commercial presence. On telecommunications a GATS-plus agreement will ensure free access by joint ventures and 100 percent ownership. For E-commerce the focus will be on equal treatment for electronically delivered goods and services by comparison with similar products delivered physically. This will include the elimination of NTBs on digital media such as software and videos.

The Korea-US FTA will be advocated by the United States as a template for TPP negotiations, since it contains very high standards. Another model will be the New-Zealand-Malaysia pact which includes GATS-plus market access commitments in education, environment, maritime, tourism, management consulting and veterinary services; it also guarantees MFN treatment in engineering and computer services. New Zealand and Malaysia agreed to review their services commitments "with a view to further services liberalization, within two years of the Agreement's entry into force."<sup>4</sup> This sort of "evergreen" provision will be attractive to TPP negotiators.

### State-owned enterprises

SOEs are important in Vietnam (for example, all telecommunications are state-run) and in Japan (Japan Post ranks among the world's largest banks and insurers), and SOEs often receive preferential treatment via low-cost government capital, exemptions from normal regulation, and favorable procurement contracts. These features concern US, Australian and New Zealand negotiators: they recognize that SOEs are a fact of life, but they seek a level playing field for private companies. The potential membership of China in a TPP pact makes the SOE chapter absolutely vital. The chapter will likely call for competitive neutrality between SOEs and private enterprises, and a high degree of transparency in SOE operations, including their financial structure.

### Intellectual property rights

Developing countries sometimes argue that excessive protection of IP rights puts them at a disadvantage. By contrast, the United States and other advanced countries argue that strong IPR standards are crucial for promoting innovation and combating patent piracy and copyright infringement. The TPP talks will follow the US playbook, but how far they go remains to be seen. The US position would enable copyright holders to stop the importation of unauthorized copyrighted goods. Such language has been included in past FTAs for patent violations but never for copyright infringement. Getting the language in the TPP will establish a benchmark for Asian countries that have a particularly poor record on IP enforcement.

For the pharmaceutical industry, the main points of contention relate to patent linkages, term extensions and data exclusivity. The US position on patent linkages advocates a mandatory "link" between marketing approval for generic drugs and the expiration of the pioneer drug patent -- meaning no party may approve the marketing of a generic drug while the original patent is still in force. The US position on term extensions would require TPP countries to compensate for delays in patent or marketing approval with longer patent terms. And the US position on exclusivity would require TPP countries to ensure *exclusive* rights to the patent holder of test data for five years, effectively prohibiting another company from using the same data to obtain marketing approval for a generic drug with identical properties.

### Agriculture

Market access for sensitive products like dairy, beef and rice are particularly contentious. Dairy positions are divided between US negotiators, who prefer to focus on technical barriers to trade (TBT) and sanitary and phyto-sanitary (SPS) issues rather than liberalizing tariffs and quotas; and others like New Zealand who are pushing for full tariff and quota liberalization. Adding Japan and Canada to the mix will complicate matters as both countries have a combination of high protection and supply management systems that are deeply entrenched in domestic politics.

Beef and rice issues will erupt if the TPP expands to include Japan, Korea, ASEAN members and eventually China. Past disputes on beef imports between the United States, Korea and Japan will resurface, but the Korea-US deal on beef set a precedent that Japan and others may have to follow. This includes a commitment to phase out restrictive tariffs. On rice, Malaysia, Japan and Korea will likely push to maintain existing tariffs to blunt competition from lower cost producers like the United States, Australia and Vietnam.

### Dispute settlement

It remains to be seen how far the parties will go in creating a regional dispute settlement system patterned after the WTO system. One issue has already sparked differences: the investor-state arbitration chapter. Many countries argue that an investor-state arbitration system impedes governments from regulating dangers in the environment, public health and safety. In fact Australia is strongly opposed, arguing that it does "not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses."<sup>5</sup> The United States on the other hand argues that foreign investors are sometimes subject to discriminatory expropriation and regulatory takings, and will press for investor-state chapter in the TPP.

## 2. Timeline

President Obama's ambitious goal of concluding initial negotiations before the APEC Summit in November 2011

4 "New Zealand-Malaysia Free Trade Agreement, Key Outcomes," *New Zealand Ministry of Foreign Affairs and Trade*, May 10, 2011. Available at <http://mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/Malaysia/Key-Outcomes.php>.

5 Gillard government's statement on investor-state dispute resolution. Available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html#investor-state>

will not be achieved. The nature of TPP has changed: it is no longer a small group of “like minded” countries negotiating a “gold standard” pact. Instead the TPP club, even at nine members, embraces diverse countries both in economic and political character. The chapters mentioned above are just a sample of the provisions that will have to be negotiated, including “frontier subjects” that have not been covered in previous trade pacts.

Moreover, if Japan and Korea indicate an interest, possibly triggering Canada and Mexico to seek seats at the table, the TPP will suddenly experience a leap both in economic weight and negotiating complexity. That will add months if not years to the timeline.

Finally, the US president has no negotiating mandate from Congress. In turn, this means that TPP partners will not put their best offers on the table, fearing that the Congress will ask for more before ratifying a pact. The painful haggling prior to Congressional ratification of the Korean and Colombian FTAs is well known in Asia. In practice, this means that President Obama (or his successor) will need something like Trade Promotion Authority from Congress before the talks get down to hard points. This inevitably extends the timeline, with 2013 the earliest possible date for a deal.

### 3. Broader regional integration

The long-term vision for regional integration entails a contest between the Asia-centric track and the TPP track. The Asia-centric model proposes intra-Asian integration through ASEAN + 1, ASEAN + 3 (Japan, Korea and China) and ASEAN + 6 (East Asian FTA plus Australia, New Zealand and India). Separately, China, Japan and Korea have embarked on talks that point to a Northeast Asia trade area. Only at a much later date, when the Asian template is firmly established around its Chinese core, would this path include all the economies of APEC, including those in the Western Hemisphere.

The TPP model on the other hands proposes a first tranche of the core nine countries, but soon expanded to include Japan, Korea, Canada and Mexico. The long-term US goal, of course, is to bring China and all of ASEAN into the TPP.

Apart from the sequence of country coverage, the overriding difference is the contest of templates. The TPP envisages deep, policy-led integration, ensured

by hard treaty obligations. Members will need to take serious, and sometimes painful, steps to ensure market access to their TPP partners, protect intellectual property, and ensure fair play by SOEs. By contrast, the Asia-centric model codifies liberalization mainly to the extent already practiced by member countries. In this critical respect, the Asia-centric model follows the ASEAN path of thin liberalization and numerous exceptions.

Looking ahead twenty years, either path could lead to a pact labeled the Free Trade Area of the Asia-Pacific - but the scope would differ greatly between the TPP model and the Asia-centric model. Alternatively, the competing paths could lead to a sharp divide between a US-led bloc and a China-led bloc, with security as well as economic overtones. As always, the future is up for grabs.

## Conclusion

In terms of tariff reductions, developed countries have Concluding a trade agreement among the current nine members will be no easy feat. Expanding the agreement to make a truly Asia-Pacific agreement will be even more challenging, but is absolutely necessary for the United States to maintain its economic standing in Asia. China is leaps ahead of the United States in terms of regional agreements and US firms could be seriously disadvantaged if the Asia-centric model becomes the dominant form of integration. The United States has one strong factor working in its favor. For a mixture of political and economic reasons, its Asian allies are showing more interest in the TPP model than the Asia-centric model. The TPP club has already expanded to include Malaysia and Vietnam, and others seem intent on signing up. Stay tuned.

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