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The Evolving US View on TPP

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Abstract

Trans-Pacific Partnership (TPP) talks were launched without fanfare by former President George W. Bush in March 2008, near the end of his term in office. But it was President Obama who, in November 2009, committed the US to work with the so-called Pacific Four (P4) countries to create "a regional agreement that will have broad-based membership and the high standards worthy of a 21st century trade agreement." I argue in this paper that the motive for engaging in TPP is largely influenced by the rapid rise of China. TPP became Obama's chosen vehicle to strengthen the US political-economic footprint in Asia, and avoid being disadvantaged politically or economically by China. The elements of the TPP package and how it evolves with time are discussed. The importance of Japan and Korea, along with the impact of the regional integration in Asia is also explored in this paper. I then conclude with a discussion on how China fits into the big picture.

Keywords: TPP; Trade Agreements; US-China relationship; China.

JEL Classification No.: F13, F15, F59.

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[*] Reginald Jones Senior Fellow, Peterson Institute for International Economics. This paper draws extensively (and sometimes verbatim) on the work of my colleagues, Jeffrey J. Schott, Peter Petri, Michael Plummer and Fan Zhai, as well as my own prior articles co-authored with Julia Muir. Presented in the Third Annual IMF-SCID Conference on Emerging Asia, "Prospects for Asian Economies", September 11-13-2013.

The Evolving US View on TPP

Gary Clyde Hufbauer[1]

Introduction

Trans-Pacific Partnership (TPP) talks were launched without fanfare by former President George W. Bush in March 2008, near the end of his term in office. But it was President Obama who, in November 2009, committed the US to work with the so-called Pacific Four (P4) countries to create “a regional agreement that will have broad-based membership and the high standards worthy of a 21st century trade agreement."[2] 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).

Why did President Obama – a known sceptic of global trade and investment -- put so much effort into an agreement when the then-nine members represented a meagre 5 percent of total US merchandise trade? Three answers at the time: China, China, and China. China’s rapid growth had fostered an assertive geostrategic behavior marked by claims in the South and East China seas, continued support of North Korea, and modest steps toward a blue water navy.[3] On the economic side, China’s burst as the world’s assembly plant and its massive accumulation of foreign exchange had challenged US manufacturing firms and US leadership of the world trade and financial systems.

Against this backdrop, the TPP became Obama’s chosen vehicle to strengthen the US political-economic footprint in Asia. Largely persuaded by Secretary of State Hilary Clinton, Obama did not want to allow the United States to be disadvantaged politically or economically by China. Hence his famous “pivot to Asia”.

[1] This paper draws extensively (and sometimes verbatim) on the work of my colleagues, Jeffrey J. Schott, Peter Petri, Michael Plummer and Fan Zhai, as well as my own prior articles co-authored with Julia Muir.

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

[3] President Hu Jintao declared that China “will stick unswervingly to the path of peaceful development, and will never seek hegemony now or in the future.” 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.

The Starting Point

In 2009, the US had trade agreements with only two Asian-Pacific economies – Australia and Singapore, The Korea-US FTA was not concluded until 2011. As early as 2009, China by contrast had trade agreements with Hong Kong, Macao, ASEAN, New Zealand, and Singapore, and was preparing to engage in talks with Japan and Korea. The scorecard says it all: at the beginning of President Obama's first term, the US was far behind in commercial diplomacy.

To team Obama, the best path forward was an expanded TPP. However the cluster of eight TPP countries assembled by the United States in mid-2011 was too small to deliver much bang. To make a significant impact, politically and economically, the TPP had to include large regional players, notably Japan in Asia, and Canada and Mexico in North America. Canada and Mexico were invited into the talks in 2012. When Shinto Abe became Prime Minister, also in late 2012, his "third arrow" of reform called for Japan to join the TPP talks, accomplished by the middle of 2013. Japan's membership increased the economic size of the TPP group by about 30%.

With these additions, the current TPP roster, known as TPP-12, now covers 12 countries, as shown in table 1. TPP-12 represents almost 40% of world GDP and 25% of global exports. On the whole, these are "like minded" countries in their pursuit of comprehensive liberalization covering goods and services, together with WTO-plus rules on investment, competition, labor and environment, and a handful of "frontier" issues, such as rules for state-owned enterprises (SOEs).

Elements of the TPP Package

US negotiators have viewed the high-standard Korea-US FTA (KORUS), ratified in 2011, as a starting template for elements in the TPP negotiations. 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. 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."[4] This "evergreen" provision should also prove attractive to TPP negotiators.

The TPP will have common obligations on most subjects, but since several TPP-12 countries have bilateral pacts between themselves (e.g., NAFTA), which will co-exist alongside the TPP, differential obligations will inevitably arise with respect to issues like rules of origin, work visas, and government procurement. Moreover, countries will have different phase-in schedules with

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

respect to “sensitive” products. The sections below sample the provisions under negotiation, but are far from comprehensive.

Services and investment

Key areas for service and investment liberalization are finance, telecommunications, and electronic commerce (E-commerce). The US 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 compared with similar products delivered physically. This will include the elimination of non-tariff barriers (NTBs), for example local content rules for servers, on digital media such as software and videos.

However, the United States faces a major handicap of its own making: the US is unwilling to bind the states in its trade agreements, and the states control the licensing and credentialing process for most services (doctors, lawyers, engineers, etc.). Further, at the federal level, the United States is reluctant to liberalize its sabotage rules for maritime and air transportation, nor is it eager to negotiate, in the TPP, regulatory rules for banks, insurers, stock and commodity exchanges and other financial services. This adds up to be a somewhat empty US bag of potential “gives” in exchange for multiple “asks”.

State-owned enterprises (SOEs)

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 taxation, and favorable procurement contracts. These features concern US as well as 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 association of China, at a future date, 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 structures.

Intellectual property rights

Developing countries sometimes argue that excessive protection of IP rights puts them at a disadvantage. By contrast, the US 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 proposal would give copyright holders the exclusive right to control the importation of legitimate copyrighted goods. This would effectively stop the practice of "parallel trade" where a copyrighted good is traded between countries – without the consent of the copyright holder – to take advantage of price arbitrage. While the US has domestic laws that prevent parallel trade of copyrighted goods, such language has not been included in its FTAs. Getting the language in the TPP would establish a benchmark for Asian countries.

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 at least 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 issues for sensitive products like dairy, beef, and rice are particularly contentious. Dairy positions are divided. 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; but Australia, New Zealand and Chile are pushing for full tariff and quota liberalization. The addition of Japan and Canada to the TPP roster has complicated matters as both countries combine high protection with supply management systems that are deeply entrenched in domestic politics.

Beef and rice issues have erupted now that TPP has expanded to include Japan (with Korea as a possible entrant in a few years). Past disputes on beef imports between the US and Japan will resurface, but the Korea-US bilateral deal on beef set a precedent that Japan may have to follow. This includes a commitment to phase out restrictive tariffs. On rice, Malaysia and Japan will push (as did Korea in KORUS) to maintain existing tariffs to blunt competition from lower cost producers like the US, Australia, and Vietnam.

Ultimately, since the United States will continue to insist on indefinite high protection for sugar, peanuts and a few other crops, and since most TPP countries have their own sacred cows, the agricultural "sensitivities" of members may balance in an acceptable package.

Labor and Environment

The United States will insist of Labor and Environment chapters in the TPP. These will reflect the so-called "May 10, 2007 agreement" between Congressional Democrats and the Bush Administration. The terms of that agreement were subsequently reflected in the Peru-US, Colombia-US, Panama-US and Korea-US FTAs. There are three essential provisions: for Labor, all countries will need to subscribe to the ILO Declaration on Fundamental Principles and Rights at Work; for Environment, all countries will need to commit to enforce their own laws; and for both subjects these obligations will need to be subject to binding dispute settlement, discussed in the next section.

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, when Julia Gillard was Prime Minister, Australia strongly opposed investor-state arbitration, arguing that it does "not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses."[5] Now that Tony Abbott is Prime Minister, Australia may change its position. All along, the US has insisted on investor-state arbitration, arguing that foreign investors are sometimes subject to discriminatory expropriation and regulatory takings. Most TPP countries seem to agree with the United States. Moreover, as mentioned, the US will insist on a strong dispute settlement system for labor and environmental issues, as well as market access questions, and very likely for rules relating to state-owned enterprises (SOEs).

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[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

Timeline and the Congress

President Obama's ambitious goal of concluding initial negotiations before the APEC Summit in November 2011 was clearly not achieved. The goal post was pushed back to the end of 2012, and predictably that deadline was missed as well. Official Washington now speaks optimistically of concluding the deal at the Bali APEC summit in mid-October 2013, but the fall of 2014 is the earliest possible date to conclude this ambitious mega-regional pact. The missed deadlines are not for lack of industrious effort: 20 negotiating rounds have been held since March 2010, and the lead ministers are conferring on a regular basis bilaterally and between scheduled meetings of the entire TPP roster.

Apart from inevitable differences of opinion among 12 countries, TPP faces obstacles in the American political system. Tense relations between President Obama and Republicans mean that any presidential initiative faces an uphill battle. In order to conclude TPP, President Obama needs Trade Promotion Authority (TPA, previously known as "fast track") to ensure a speedy up-or-down Congressional vote on the negotiated package, without amendments and without a Senate filibuster.

At the moment, President Obama does not have a negotiating mandate from Congress. In turn, TPP partners are reluctant to put their best offers on the table, fearing that the US Congress will ask for more before enacting TPA. The painful haggling prior to Congressional ratification of the Korean and Colombian FTAs is well known in Asia.

Since the 1960s, Republicans have favored trade agreements, normally by around a two-thirds majority, but Democrats have swung the other direction (including, when he was a Senator from Illinois, Barack Obama). What this means is that, despite the energetic support of Senate Finance Committee Chairman Max Baucus (D-MT) and House Ways and Means Committee Chairman David Camp (D-MI), passing Trade Promotion Authority (TPA) will take considerable White House effort to cajole reluctant Congressional Democrats.

The White House will have to navigate the call for a "currency chapter" in TPP, endorsed by 60 Senators. In addition, the White House will have to mollify legislators who have demands relating to industries in their states or districts. Legislators representing Michigan, for example, are insisting on a long phase-in period before Japanese autos can enter the US market tariff-free. Ambassador Michael Froman has already excluded the maritime industry from TPP talks, in deference to the Jones Act of 1922. Other sacred cows of US trade policy – sugar, dairy, textiles, apparel -- will insist on special treatment. Immigration (H1-B and L visas) will never get on the table. TPP will not be a cake walk, but it is certainly achievable. An overriding reason, from the US political perspective, perhaps surprisingly, is Japan.

The Importance of Japan and Korea

If Japan opens its major agricultural markets (except for rice) to US products as part of the TPP bargain – beef, pork, wheat, corn – a veritable stampede of mid-Western Congressmen will rush to support TPP. Japan can achieve this reform by buying out its farmers by providing generous subsidies for the working lives of its elderly agricultural population. Moreover, if Japan opens its service markets to foreign competition, many large US service firms and their Congressional friends will join the bandwagon.

On the other hand, if Japan refuses to liberalize its major agricultural markets and key services, TPP will face an exceedingly rough ride in the US Congress. Fortunately, the odds favor Japanese reform. Despite some contrary rhetoric, Prime Minister Shinzo Abe knows that agricultural reform and service liberalization are both critical to Japanese growth prospects. Equally important, in his geopolitical strategy, Abe is depending on a strong political-military alliance with the United States, and reliable access to US natural gas.

Taken together, the forces suggest that Japan will not only embrace a high standard TPP but will make an important, if indirect, political contribution to ratification by the US Congress.

From a US standpoint, the KORUS FTA already delivers practically everything that could come from Korea's membership in TPP. From a Korean standpoint, joining the TPP would entail extending agricultural concessions to other countries to new partners such as Australia, Canada, and New Zealand. Korea in the partnership will add to TPP's economic appeal for partners other than the United States, but since freer trade is not particularly popular in Korea at the moment, this enlargement is likely to come only after the initial deal is signed and sealed. Much the same observation applies to other outsiders, like Indonesia, Thailand and the Philippines.

Asian Regional Integration

Over the next decade, Asian regional integration will entail a contest between the RCEP track and the TPP track. The TPP-12 could conceivably enlarge to TPP-16 (see table 2) within a few years. The Regional Comprehensive Economic Partnership (RCEP), already embraces 16 countries including China and India, but is moving forward at a slow pace. Notably RCEP excludes the United States and TPP excludes China, and as table 2 indicates, the US doesn't benefit from RCEP and China doesn't benefit from TPP.

Apart from the pace of negotiations, the extent of country coverage, and the distribution of gains, 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 RCEP model seems on a path to codify liberalization to the extent already practiced by member countries. In this critical respect, the RCEP model follows the ASEAN path of thin liberalization and numerous exceptions.

Looking ahead 20 years, either path could lead to a pact labelled the Free Trade Area of the Asia-Pacific (FTAAP), as portrayed in table 2, but the scope would differ greatly between the TPP model and the RCEP 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: How Does China Fit?

China's priority at the moment is deepening its ties with Asian neighbors, and China is pursuing these political-economic goals through RCEP and the China-Japan-Korea (CJK) framework. TPP is not part of China's current diplomatic outreach, but in 2013, unlike 2012, Chinese officials have dropped their rhetorical hostility to TPP. No longer do officials characterize TPP as a "contain China" initiative. Nor, despite the geostrategic origins of TPP in the first Obama Administration, do US officials ever let a "contain China" phrase slip from their lips.

Signs of renewed interest in market precepts can be seen in President Xi Jinping's initiatives. His government has re-kindled Bilateral Investment Treaty (BIT) talks with the United States and expressed interest in the Trade in International Services Agreement (TISA). It is said in Geneva, behind the scenes, that China has taken a positive approach towards achieving a successful WTO Bali Ministerial Conference in December 2013. Quietly and indirectly, in other ways, Chinese leaders are exploring closer economic ties with the United States.

These are early days and the prospects are distant. But conceivably the high standards of liberalization envisaged in the TPP template – adopted across Asia, including China – will entrench market practices and precepts in the world's most dynamic region.

Table 1. TPP-12: Like-minded but not alike

Country	2012 GDP ($US billions)	Population (millions)	Human Development Index[a]	Economic freedom in world index[b]
Australia	1,586	23	0.929	7.97
Brunei	18	0.4	0.838	n.a.
Canada	1,805	34.9	0.908	7.97
Chile	272	17.6	0.805	7.84
Malaysia	306	29.2	0.761	6.96
Mexico	1,208	114.9	0.77	6.66
New Zealand	181	4.5	0.907	8.27
Peru	185	30.5	0.725	7.61
Singapore	270	5.4	0.866	8.69
United States	15,610	314.7	0.91	7.69
Vietnam	135	90.4	0.593	6.54
Japan	5,981	127.3	0.901	7.64
Total: TPP-12	**27,557**	**793**		
World	**71,897**			

[a] The Human Development Index (HDI) is published by the United Nations Development Program. The index comprises six indicators: life expectancy at birth, mean years of schooling, expected years of schooling, per capita gross national income (GNI), GNI rank, and non-income HDI value. The index is on a scale of 0 to 1, where 0 is the lowest and 1 indicates the highest level of human development.

[b] The index published by the Fraser Institute (2012) measures the degree to which the policies and institutions of countries are supportive of economic freedom. The index assesses five broad areas: size of government, legal structure and security of property rights, access to sound money, free to trade internationally, and regulation of credit, labor and business. Countries are ranked on a scale of 0 to 10, with 10 representing more economic freedom.

Source : IMF WEO 2012.

Table 2. Potential country income gains, 2025 (US$ billions)

Country	**TPP-16**	**RCEP**	**FTAAP**
United States	108	0	267
China	-84	297	678
Japan	129	96	228
ASEAN	218	76	210
Others	79	176	539
World	451	644	1,922

TPP = Trans-Pacific Partnership; RCEP = Regional Comprehensive Economic Partnership; FTAAP = Free Trade Area of the Asia-Pacific; ASEAN = Association of Southeast Asian Nations

Note: TPP-16 is based on a scenario of enlarging the TPP talks from the current TPP-12 countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, Vietnam) to a group of 16 countries which include Korea, Indonesia, the Philippines and Thailand.

Source: Petri, Plummer, Zhai (2012).