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AIIA Policy Commentary

Pathways to the Same Destination? Free Trade Negotiations in the Asia-Pacific

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Potential Failure to Game Changer
Professor Bryan Mercurio

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A Trade Trojan Horse?
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Preface

The Australian Institute of International Affairs (AIIA) was established in 1924 as an independent, non-profit organisation seeking to promote interest in, and understanding of, international affairs in Australia.

The AIIA provides a wide range of opportunities for the dissemination of information and free expression of views on these matters through discussion and publication. Precluded by its constitution from expressing any opinion of its own on international affairs, the AIIA provides a forum for the presentation, discussion and dissemination of a wide range of views.

The AIIA's series of Policy Commentaries aims to provide informed opinion and useful source documents on issues of topical concern to encourage debate among AIIA members, the media and the general public.

The Commentaries are edited by Melissa Conley Tyler, National Executive Director in the AIIA National Office, Canberra. I hope that you will find the current commentary timely and informative.

Associate Professor Shirley Scott
Research Chair
Australian Institute of International Affairs
Series Editor 2012-2013

Editorial

For Australia, the “destination” for trade negotiations is clear: the reduction of barriers to trade, whether through reduced tariffs or removal of behind the border barriers. This has a clear economic benefit for Australians in the form of increased market access for Australian exporters and reduced cost of imports for Australian consumers.

However the “pathway” to achieve trade liberalisation is more complex, and becoming increasingly so. Australia’s historic preference has been for multilateral trade liberalisations through the World Trade Organization and its predecessor. However with the WTO’s Doha Round not yet concluded (it’s been termed as “dead as a Doha”), Australia has been pursuing bilateral free trade agreements.

Most recently, attention has turned to the potential for regional free trade agreements. While discussion of a potential free trade agreement of the Asia Pacific has been part of the APEC agenda for years, two other initiatives have ended up at the vanguard: the Trans-Pacific Partnership (TPP) and, more recently, the Regional Comprehensive Economic Partnership (RCEP).

TPP started life as an initiative of smaller, free-trading states, but with the entry of the US in 2008, it has become a vehicle for US trade negotiations. RCEP, launched in 2006, is led by ASEAN and includes some of Australia’s major trade partners not in the TPP such as China, South Korea, India and Indonesia.

Australia is currently part of both negotiations. In the words of Minister for Trade Craig Emerson in November 2012: “We now look like we're going to have two pathways to the one destination: a free trade area of Asia and the Pacific. This is very heartening – and if one set of negotiations lends momentum to the other set of negotiations that's all for the good.”*

This policy commentary charts the implications of these negotiations for Australia’s trade and foreign policy more broadly.

Bryan Mercurio of the Chinese University of Hong Kong charts the history of the TPP and the game-changing entry of Canada, Mexico and, particularly, Japan. Stephen Grenville of the Lowy Institute casts a cautious eye over the regulatory issues being negotiated in the TPP and looks at the implications for Australia of signing. Finally, Peter Drysdale and Jayant Menon in pieces published in the East Asia Forum contrast RCEP with the TPP and delineate the recent challenges faced by RCEP.

With such issues at stake, even those who are not involved in trade should take an interest in current developments.

Melissa H. Conley Tyler
National Executive Director
Australian Institute of International Affairs

* Joint press release by Minister for Trade Craig Emerson and Prime Minister Julia Gillard, 20 November 2012, available online at http://trademinister.gov.au/releases/2012/ce_mr_121120.html

**Media Release by Prime Minister Julia Gillard and
Minister for Trade and Competitiveness
Craig Emerson,
Phnom Penh, Cambodia, November 2012***

Prime Minister Julia Gillard, accompanied by Trade and Competitiveness Minister Craig Emerson, today joined leaders from 15 countries of the Asian region to launch negotiations for a new trade agreement, the Regional Comprehensive Economic Partnership (RCEP).

RCEP will bring together the ten ASEAN countries, along with Australia, China, India, Japan, Republic of Korea and New Zealand. The 16 countries account for almost half the world's population and 30 per cent of global GDP.

The Prime Minister and Minister Emerson congratulated ASEAN on initiating RCEP.

Australia's participation in RCEP delivers on the vision for Australia's engagement with Asia set out in the Australia in the Asian Century White Paper.

RCEP will support the goal of a more open Australian economy, integrated with Asia, and help improve the flow of goods, services, capital and ideas.

The countries involved include nine of Australia's top 12 trading partners and account for almost 60 per cent of our two-way trade and 70 per cent of our exports.

* Available online (accessed 20 June 2013):
http://trademinister.gov.au/releases/2012/ce_mr_121120.html

RCEP will form part of the Government's strategy for lowering trade barriers and securing improved market access for Australian exporters of goods and services and Australian investors.

The agreement will provide Australian businesses with a genuinely regional platform for trade and investment decisions, enabling them to compete and succeed in regional value chains.

RCEP will build on the high-quality free trade agreement that Australia already has with ASEAN and New Zealand. It will complement Australia's participation in bilateral trade negotiations and in Trans-Pacific Partnership (TPP) negotiations.

Australia's participation in each of these negotiations will add momentum to the process of competitive trade liberalisation.

**Speech by Prime Minister Julia Gillard,
ASEAN Business and Investment Summit,
Bali, November 2011***

[....]

Friends, I recently turned 50 and I was thinking about the Asia I learned about as a young girl back in the 1960s. It was a region of poverty, colonialism, ideology and war.

The reality, a few short decades later, couldn't be more different - for Asia, and for Australia's place in it. The region is growing in prosperity, peaceful and strong. And for my nation, these have been remarkable years of learning and engagement.

Years in which we came – not always easily – to see our place in Asia as a source of strength. To celebrate the “advantage of adjacency” to our own neighbourhood rather than fear the “tyranny of distance” from our Northern Hemisphere origins.

It is true we come from many cultures; many different histories; many political traditions. But our objective is the same: to strengthen and deepen our economic, political and security cooperation across the Asian region.

[....]

Regional leaders affirmed that Asia and the Pacific will not wait for the rest of the world to move the free trade agenda forward. The Trans Pacific Partnership stands to become a free trade zone bigger than the European Union. But only if we avoid becoming mired in the quibbling and controversy that has beset Doha.

* Available online (Accessed 20 June 2013): <http://www.pm.gov.au/press-office/address-asean-business-and-investment-summit-bali>

Now it's time for TPP supporters to make this Agreement a reality, translating the consensus and goodwill of last week into a concrete deal next year. And, of course, our job doesn't end there. We need to push for further structural reform. Reform that will promote confidence and allow business to create jobs and drive productivity throughout the region and across the globe.

As governments and as businesses we must not respond to uncertainty by closing markets or turning away from reform. Governments need to focus on trade and give business the conditions that encourage growth, including through entrepreneurship and innovation. The driving force behind government measures is the desire to build resilient economies because it is resilience that provides the stable environment which promotes open trade and investment.

But sustainable economic growth is only possible where there is certainty, and the EAS provides a collaborative framework for regional stability and growth. The key to growth in the region and the resultant jobs is economic openness.

The member nations of the EAS will use our position in the G20 to deal with structural imbalances. At APEC to open the region as a whole. And through a comprehensive agenda of Free Trade Agreements to deepen country-to-country economic ties.

We need effective regionalism through institutions with the right membership and mandate to address the full range of security, political and economic issues facing the region. The EAS has made a strong start to what I believe will be a great history of cooperation between nations who have not always been friends.

We have learned from our history and moved on from it. We understand the need for cooperation and convergence. And we are beginning to see just what a more united Asia can mean for our region and for the world.

This is moment of opportunity and a time of hope. Let's master its challenges and seize its opportunities. In the ASEAN spirit. As partners – as neighbours – as friends. Together.

Joint Statement from ASEAN regarding the Regional Comprehensive Economic Partnership, Brunei Darussalam, May 2013*

1. Officials of the 16 governments participating in the Regional Comprehensive Economic Partnership (RCEP) – the 10 ASEAN Member States and its Free Trade Agreement Partners (Australia, China, India, Japan, the Republic of Korea and New Zealand) – today met in Brunei Darussalam to start detailed negotiations aimed at concluding RCEP by the end of 2015.

2. Consistent with the RCEP Leaders' Joint Declaration on the Launch of Negotiations for the RCEP of 20 November 2012 and the Guiding Principles and Objectives for Negotiating the RCEP endorsed by RCEP Ministers on 30 August 2012, the RCEP negotiations will aim to:
 - i. achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement establishing an open trade and investment environment in the region to facilitate the expansion of regional trade and investment and contribute to global economic growth and development; and
 - ii. boost economic growth and equitable economic development, advance economic cooperation and broaden and deepen integration in the region through the RCEP, which will build upon our existing economic linkages.

3. Negotiations for the RCEP will recognize ASEAN Centrality in the emerging regional economic architecture and the interests of ASEAN's FTA Partners in supporting and contributing to economic integration, equitable economic development and strengthening economic cooperation among the participating countries.

* Available online (Accessed 20 June 2013):

http://www.asean.org/images/2013/other_documents/Joint_statement_1st_RCEP%20TNC_08May2013_final.pdf

4. The RCEP will have broader and deeper engagement with significant improvements over the existing ASEAN+1 FTAs, while recognizing the individual and diverse circumstances of the participating countries.

5. The RCEP will include provisions to facilitate trade and investment and to enhance transparency in trade and investment relations between the participating countries, as well as to facilitate the participating countries' engagement in global and regional supply chains.

6. Taking into consideration the different levels of development of the participating countries, the RCEP will include appropriate forms of flexibility including provision for special and differential treatment, plus additional flexibility to the least-developed ASEAN Member States, consistent with the existing ASEAN+1 FTAs, as applicable.

7. The second round of RCEP negotiations is scheduled for 23-27 September 2013 and will be hosted by Australia.

**Press Release by the Office of the United States
Trade Representative regarding the
Trans-Pacific Partnership,
Lima, Peru, May 2013***

During the 17th round of Trans-Pacific Partnership (TPP) negotiations, which ended today, officials reported that they continued to forge ahead toward their goal of concluding an ambitious 21st-century agreement in the timeframe envisioned by President Obama and the Leaders of the other ten TPP countries. Through the TPP, the United States is seeking to advance a next-generation trade and investment agreement that will enhance U.S. competitiveness, expand U.S. trade in the Asia-Pacific region, and support the creation and retention of U.S. jobs, while at the same time promoting labor rights, environmental protection, and transparency.

In their work during this 10-day round, negotiators were guided by the plan of action agreed by the trade ministers from the United States and the other TPP countries – Australia, Brunei Darussalam, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam – when they met last month on the margins of the Asia-Pacific Economic Cooperation (APEC) meeting in Surabaya, Indonesia. In line with that plan and the direction of ministers to find pragmatic solutions to outstanding issues, the negotiators made progress across the agreement. The negotiating groups covering services, government procurement, sanitary and phytosanitary standards, trade remedies, labor, and dispute settlement moved their work forward significantly. The TPP countries also successfully advanced work on the other legal texts, including technical barriers to trade, e-commerce, rules of origin, investment, financial services, intellectual property, transparency, competition, environment and other issues. On the more challenging issues of intellectual property, competition, and environment, negotiators had productive discussions and agreed on next steps to continue their work.

In addition, negotiators made further progress on building the comprehensive packages that will provide access to their respective

* Available online (Accessed 20 June 2013): <http://www.ustr.gov/about-us/press-office/press-releases/2013/may/tpp-negotiations-strong-momentum>

markets for industrial, agricultural and textile and apparel products, services and investment, and government procurement. They moved forward in constructing tariff packages and rules of origin, reflecting input from stakeholders on how best to promote trade and regional integration that would benefit the companies and workers in the United States and the other TPP countries.

The 11 TPP countries discussed plans for smoothly integrating Japan into the TPP negotiations. Japan will join the negotiations following the successful completion of current members' respective domestic processes. With Japan's entry, TPP countries will account for nearly 40 percent of global GDP and about one-third of all world trade.

On May 19th, the TPP negotiations were temporarily suspended so negotiators could meet with the 300 stakeholders from the United States and other TPP countries. Stakeholders presented views to negotiators on a wide range of issues under discussion in the TPP, and met informally with U.S. and other negotiators to provide further input to them. Barbara Weisel, U.S. chief TPP negotiator, and the chief negotiators from the other 10 countries also briefed stakeholders on the status of the negotiations and responded to their questions on specific issues and the process going forward.

Ministers from the TPP countries will continue to engage regularly over the coming months to guide the negotiators' work, find solutions to outstanding sensitive issues, and ensure that the negotiations achieve the TPP Leaders' objective of a high-quality, ambitious, and comprehensive agreement this year. Meanwhile, the negotiating teams agreed on detailed intersessional work plans so that the momentum achieved during this week's round in Lima can be maintained.

The 18th round of TPP negotiations will be held in Malaysia from July 15th-25th.

Speech by Director General Pascal Lamy of the World Trade Organisation, Beijing, China, September 2012*

[...]

Multilateralism and regionalism

This morning I will address the multilateral trading system and regional economic cooperation. The title is well chosen in the sense that the multilateral reference is to trade, while at the regional level the title refers to economic cooperation. What this conveys is that we are not exactly comparing alternative approaches that have identical objectives. Regional initiatives are often broader and more encompassing than the more focused concerns of the WTO. This is entirely natural, as regional neighbours may share concerns and interests that do not necessarily so directly concern those that are further away. More than one venue for cooperation in similar and sometimes overlapping areas of policy or economic activity may therefore be desirable.

This is not to say that multilateral and regional cooperation are always perfectly synchronized and complementary. They are not. Moreover, quite a number of so-called regional cooperation agreements are not regional at all — they extend across regions. In fact, about half of all preferential trade agreements in existence are not strictly regional. To a degree then, there can be no question that these agreements are sometimes treated as a substitute for a multilateral approach, and that is a part of what we shall discuss.

But just as the WTO cannot address all the needs that receive regional attention, so regional agreements cannot do certain things for which the WTO is indispensable. This is true for key aspects of coordination in the absence of which we could be threatened with divisive policy divergence. It is also true for certain areas of policy, such as subsidies.

* Available online (Accessed 20 June 2013):
http://www.wto.org/english/news_e/sppl_e/sppl246_e.htm

The rise of regionalism

When the GATT first came into being in 1948, regional arrangements were considered exceptional. Indeed, it was not until the beginnings of the European integration process in the 1950s that a significant part of international trade was to become preferential. In the ensuing years, several other preferential agreements were established, but it was not until the 1980s that they started to become the significant component of world trade that it is today. The major increment in the number of agreements came in the 1990s. We can count almost 400 preferential trade agreements currently in existence, and each member of the WTO on average belongs to 13 separate agreements.

A number of reasons can be adduced to explain their rising and continuing. They may serve political or strategic ends. Countries may wish to go further and faster in the direction of economic integration than they have been able to do in the WTO. They may be motivated by a fear of exclusion as competing countries secure better access to markets of interest. They may be an insurance policy against future protectionism. They may act as a signalling device to attract foreign investment. They may also serve as a vehicle for policy consolidation nationally, using an international obligation to make it harder for domestic interests to exert an influence over trade policy.

Tariffs and preferential trade agreements

Recent evidence would suggest that preferential trade agreements cannot be predominantly about securing tariff preferences. This is partly because over half of world trade is already duty-free on a most-favoured-nation (MFN) basis. The WTO's World Trade Report 2011 calculated that only about 15 per cent of global merchandise trade flows in 2008 enjoyed preferential tariff treatment. This somewhat surprising figure was not only accounted for by the extent of MFN duty-free trade, but also by the fact that preferential agreements have often not departed from MFN tariff rates where those rates are above average. Some two-thirds of tariff lines with MFN tariffs exceeding 15 per cent have not been preferentially reduced in PTAs. In effect, less than 2 per cent of world trade is eligible for preference margins in excess of 10 percentage points.

It is also noteworthy that non-preferential MFN tariffs are low. On average, they were equal to 4 per cent in 2009. These numbers lead us to the conclusion, then, that tariffs have diminished in significance as a trade policy instrument over the years, and that tariffs do not motivate preferential trade agreements in any significant measure. This does not mean that tariffs no longer matter. High rates in some sectors — what we call tariff peaks in our jargon — and nuisance tariffs in others still deserve policy attention.

Deep integration, global value chains and non-tariff measures

An analysis of the contents of the more far-reaching preferential trade agreements that have emerged in recent years would suggest a marked tendency for these agreements to go more deeply into policy areas that have been addressed less profoundly, or not addressed in the WTO. This relates both to a range of non-tariff measures (NTMs), such as product standards, and to other areas, such as investment and competition policy.

One reason for deep integration has been the emergence of global value chains. Until not long ago, we thought of products in terms of a single national origin, bearing a label saying “made in China” or “made in Germany”. The expansion over the last two decades or so of global value chains means that most products are assembled with inputs from many countries. In other words, today’s goods are increasingly “made in the world”. Trade in intermediate goods — a proxy for global value chain production — now comprises close to 60 per cent of total trade in goods, and continues to be a dynamic sector in international trade.

An important consequence of the evolution of production networks is that imports matter as much as exports and both contribute to job creation and to growth. These relationships reflect a new and more intense form of interdependency through trade.

The characteristics of NTMs and their motivations

If we understand preferential trade agreements, at least in some measure, as a desire to support and facilitate global value chains, and tariffs are not the

real story behind them, we must then look towards non-tariff measures — NTMs — to analyse the significance of the relationship between multilateral and preferential approaches towards trade cooperation.

NTMs encompass a very broad range of policies — simply any measure that is not a tariff. A broad distinction for our purposes is between NTMs that could be tariffs and NTMs that serve specific public policy objectives, such as health, safety or the quality of the environment. NTMs that simply replace tariffs are largely frowned upon by the WTO rules because they will often be protectionist in intent and they can largely be treated as a market access issue.

Those NTMs intended to address public policy matters raise altogether different considerations. Governments are obviously not going to eliminate such measures in the name of promoting international competition. On the contrary, they will consider the attainment of public policy objectives of paramount importance. The question then is how these measures are designed and how they are implemented. In effect, the danger from a trade policy perspective is that they may be designed or implemented in ways that unjustifiably restrict trade. When NTMs become dual purpose instruments in this manner, we are forced back to classic trade policy concerns about interventions that influence the conditions of competition within a market.

The distinction between legitimate and less legitimate NTMs in trade policy discussions is highly complex and challenging. This is compounded by the reality that not all nations share the same priorities, either because of distinct social and cultural perspectives, or because different levels of income and development affect the capacity of countries to pursue particular objectives. Whichever the reason, we are living in a world where diversity is a reality and we have to walk a fine line between respecting that diversity and trying to eliminate it.

I do not think it is far-fetched to argue that the proper management of NTMs is among the greatest challenges we face in international cooperation. And levelling the playing field in this area raises challenges of a different nature to those related to tariffs. Let me add another element which can add to the complexity. There can be more than one road to the

same destination. If public policy is pursued with one approach in one preferential trade agreement and another approach in a different preferential agreement, this can frustrate trade between the two agreements even if there is no intention to do so. This possibility of incidental divergence strengthens the case for multilateral coherence.

Multilateral approaches to achieving coherence among PTAs

It is therefore important that we look at how to manage the relationship between preferential trade agreements and the multilateral trading system in ways that support world trade. The starting assumption being that preferential trade agreements are not going to disappear any time soon.

One suggestion is to continue to negotiate and construct a multilateral framework that responds to those needs manifested in preferential agreements that can be met through a multilateral approach. This could include revisiting the existing rules on preferential trade arrangements such as those in Article XXIV of GATT.

Some have also argued for a process that builds gradually towards a better understanding among WTO members of preferential trade agreements, what motivates them, and how they are both similar and different. This would be not so much a negotiation as a conversation in the first instance, of the kind that could possibly be carried out under the Transparency Mechanism recently established as a forum for notifying and discussing PTAs. The ultimate objective of this exercise would be to build on those elements of commonality in preferential trade agreements that could be multilateralized on a non-discriminatory basis. As our publication “World Trade Report 2011” indicated, it is about “coherence” rather than just “coexistence”.

My concluding thought is this: as an international community, we must continue to fight protectionism, but in the WTO in particular, we must also fight policy fragmentation.

The Trans-Pacific Partnership: Potential Failure to Game Changer

Professor Bryan Mercurio*

This policy commentary argues that the entry of Canada, Mexico and most importantly Japan has dramatically shifted the prospects and potential impact of the Trans-Pacific Partnership Agreement (TPP). Despite its prominent position in the trade policy sphere for some time, this was simply hyperbole resulting from the persistent failure and slow death of the WTO Doha Round of trade negotiations. Prior to 2012, the TPP was in danger of becoming a failed agreement. The potential economic gains on offer were always going to be small given that protectionist forces had successfully managed to gain sway in all of the ‘major’ negotiating countries. Moreover, the long-term US interest in establishing a template of innovations and rule-making to be spread through future free trade agreements (FTAs) and potentially multilateralised back to the WTO likewise looks set to fail. Finally, despite the limited benefits, the TPP risked causing serious geopolitical harm with many leading countries of the Asia-Pacific not invited or otherwise not participating.

The entry of Canada, Mexico and Japan has not only changed the negotiating dynamic, but also the prospects of the agreement as a whole. Their entry to the TPP negotiations has also had an immediate and clearly visible effect on negotiating countries and beyond. For these reasons, the entry of Canada, Mexico and Japan into the TPP can be called a ‘game changer’. This policy commentary reviews some of these effects.

Pre-2012 Negotiations: And the Point is...

The aims and objectives of the TPP are to enhance economic opportunities; to establish a new regulatory framework which goes far beyond current architecture at the multilateral, regional and bilateral level; and to provide a

* Professor Bryan Mercurio is the Vice Chancellor’s Outstanding Fellow of the Faculty of Law and Associate Dean (Research) at the Chinese University of Hong Kong.

platform for meaningful economic engagement in the Asia-Pacific. Without Canada, Mexico and Japan, the TPP was at risk of failing to meet these aims and objectives.

Prior to 2012 the TPP involved the United States (US) and eight significantly smaller economies: Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore and Vietnam. With existing FTAs with Australia, Chile, Peru and Singapore, the TPP represented very little prospects for economic gain for most countries. Looking closer at the numbers, total GDP of the TPP countries came in at approximately \$17.8 trillion in 2011, with the US representing 85 percent of the total amount.¹ Trade with TPP countries accounted for a mere 5 percent of US trade, with exports worth approximately \$105 billion and imports \$91 billion. Thus, for the US the TPP was a negotiation with limited economic benefits. This was due primarily to the market size of the trading partners as well as its existing network of FTAs with four out of the five largest economies in the negotiations (with Malaysia being the exception). Even assuming widespread market access commitments, estimates of US economic gains started at \$5 billion a year and rising to \$14 billion annually over a ten-year period.

For the US economy these gains are miniscule, so it seems reasonable to conclude that the alternative aim of establishing a new negotiating template was always the main US objective as part of its broader ‘pivot’ or ‘rebalancing’ to Asia.² The comments of US President Barack Obama at an APEC Summit in 2011 confirm this interpretation of US strategy: ‘the TPP has the potential to be a model not only for the Asia Pacific but for future trade agreements.’³

This explanation for US leadership in the TPP is even more likely given the World Trade Organization (WTO) is failing in its ‘legislative’ role due to internal gridlock. The WTO has played an invaluable role in framing the basic principles and rules for global trade. However, much like in the late-1970s, the rules need updating. In the 1970s, non-tariff barriers such as trade remedies, standards and even government procurement began to be addressed. These rules were more clearly articulated in the Uruguay Round of trade negotiations, which also created the WTO in 1995. Now the world has moved on and new issues have emerged which similarly deserve the

attention of the world trading system. The trade issues currently taking prominence require new solutions not currently available at the multilateral trading system. The so-called ‘21st Century issues’ involve straightforward items such as trade in energy and competition law, to more complicated items such as rules regulating state-owned enterprises (SOEs) and currency manipulation. Existing trade issues, such as government procurement, services and intellectual property are also in dire need of reform. Moreover, and perhaps most importantly, issues relating to harmonisation of standards – often now dubbed regulatory coherence – and reform of the rules of origin regime seem to be the most promising in terms of yielding real trade gains. However they are not yet being discussed in a meaningful way at the WTO.

With this backdrop, the US clearly entered the TPP with a view to rulemaking: that is, creating a new standard for the 21st century that can be spread not only as a template for subsequent FTAs, but also can be multilateralised back to the WTO at some point in the future. The main advantage to raising these issues in the TPP, as opposed to multilaterally or in a bilateral FTA, is not only that the TPP offers the opportunity to get a coalition of countries to agree to (and hopefully subsequently promote and spread) the new standards, but also that it avoids negotiating these issues with perennial thorns, namely Brazil, China and India, until some further date in the future. By the time the US will seek to multilateralise these innovations, the US no doubt hopes it would have a large entourage of FTA partners behind it in advocating for the multilateralisation of these norms and standards.

Prior to 2012, there was some doubt as to whether the US would have enough support from economically meaningful countries to begin the regionalisation component of the strategy, let alone to meet its ultimate aim. Moreover, TPP negotiating partners were not quietly acquiescing to the full platform of US demands. Even the establishment of a new negotiating template appeared in doubt.

The Game Changers: Canada, Mexico and Japan

The addition of current North American Free Trade Agreement (NAFTA) partners Canada and Mexico as well as Japan not only adds significantly to the economic weight of the TPP but also improves the likelihood of an ambitious template being established and spread. Moreover, the addition of the new negotiating partners has also had an immediate geopolitical effect in the region and beyond.

Economically, the addition of Canada, Mexico and Japan increases the GDP of TPP countries to \$26.6 trillion, covering approximately \$650 billion of US exports and \$800 billion of imports. This dramatic increase raises the coverage of US trade from 5 percent to nearly 40 percent. In terms of trade in services, US exports to the five TPP countries where statistics are accurate totaled \$28.9 billion in 2010 while imports totaled \$13.5 billion. With the new additions, US exports of services to TPP countries will rise to \$148.3 billion and imports to \$76.4 billion. The entry of Canada, Mexico and Japan not only adds to total trade, but also significantly boosts the actual and potential gains from trade. In fact, due to the expected increased market access to bigger markets, the new entrants double potential US gains in trade in goods and services.

Looking deeper into these statistics, the importance of Japan to TPP-led economic growth becomes evident.⁴ Canada and Mexico add economic clout to the TPP, but these countries are already in a deep trading relationship with the US as partners in the NAFTA. Japan is the world's third largest economy – larger than all of the other negotiating parties combined (apart from the US). Importantly, it does not have comprehensive FTAs with many of the TPP parties and maintains considerable tariff and non-tariff barriers to trade and investment. It has been estimated that Japan's entry into the TPP could triple the economic gains accruing to the US from the TPP. Other TPP partner countries will also likely see radically improved economic forecasts. In total, removing the US economy from the equation, Japan's entry into the TPP doubles the economic value of the agreement to all TPP negotiating countries. For this reason, it is understandable why Japan's Ambassador to the US, Kenichiro Sasae, recently stated: "Without Japan, [the TPP is] a small exercise."⁵

Simply stated, the entrance of Canada, Mexico and Japan into the TPP fundamentally changes the potential economic benefits which all TPP countries can expect to derive from this agreement. In this regard their entry into the TPP is a game changer.

The entry of Canada, Mexico and Japan into the TPP may also be a game changer in promoting the formation of a new negotiating template with innovations and rule-making at its foundation. These countries will support both the negotiating model and push the regionalisation and ultimately multilateralisation of the norms, standards, rulemaking and framework that the TPP establishes. Like the US, Canada, Mexico and Japan appear to support high quality FTAs and envisage the TPP as a platform for creating and disseminating innovations in rulemaking.⁶ For instance, all support strong intellectual property protection and enforcement standards, expansion of discipline on government procurement and reduction in barriers to information technology (IT) products. They also support expansion of services trade and liberalisation, strong investment protection and meaningful environmental and labour standards. Likewise, all favour of US initiative on regulatory coherence as a way to reduce costs and promote efficiencies. These issues are controversial both within the negotiating rooms and among commentators.⁷ Thus the inclusion of Canada, Mexico and Japan provide the US with three powerful allies in pushing for high standards and innovative rulemaking in the TPP.⁸

Moreover, prior to 2012 the US was *the only* hub of the agreement, with any movement or concession in the negotiations predicated on the US opening up its domestic market. Whether it be, for instance, opening up the dairy market to Australia and New Zealand or textiles and apparel to Vietnam, negotiating partners seemingly refused to agree on any rule-making or template innovations unless and until the US offered market access commitments. For some time, it appeared these deadlocks could only be solved by the US offering deep and genuine concessions or reducing its ambition for the TPP, that is, by taking certain requests off the table which would mean the TPP may not have matched the ambition of a high standard, 21st century agreement. The entry of Canada, Mexico and Japan will change the negotiating dynamic, as now additional potentially lucrative markets are added to the negotiations. More room for compromise

and deal-making will exist and movement on rule-making and innovations are more likely to occur.

The admission of the new entrants to the TPP, in particular Japan, has already had an immediate and significant geopolitical effect on the region. Almost immediately upon announcing its intent to join the TPP, Japan set off a chain reaction with far reaching consequences. For instance, China quickly announced it was fast-tracking a feasibility study of a China-Korea-Japan trade agreement (CKJ) and also (along with ASEAN) dropped its opposition to an ASEAN+6 agreement. This has now been dubbed the Regional Comprehensive Economic Partnership (RCEP) which recently concluded its first negotiating round. Likewise, the EU announced its intention to proceed to FTA negotiations with Japan. For the simple effect that Japan's announcement has had on other regional initiatives, Japan's entry into the TPP is a game changer.

The TPP is also a game changer in that it cements the shift in negotiating strategies among the major trading nations. Until recently, most large trading nations followed a 'hub and spoke' model of negotiating a web of similar agreements with a large number of smaller countries. The TPP cements the trend towards the mega-regional agreement. With RCEP and CKJ following suit, the world has moved beyond what was the negotiating norm for several decades. These mega-regional agreements have quickly followed the tactical shift at the bilateral level, with negotiating success between US-Korea, EU-Korea, and China-ASEAN and continuing negotiations at various stages between Canada-EU, US-EU and EU-Japan.

It is also important to note the geopolitical importance of the TPP in and on the Asia-Pacific region. With China notably absent from the negotiations and having never received an invitation, the question many commentators ask is whether the US and other negotiating partners are using the TPP to contain China. This is certainly the prevailing sentiment among commentators, if not the Government, in China.⁹ Indeed, it seems clear that some countries, perhaps even including the US, see the TPP as both a hedge and a balance against China. This suggests that the TPP is serving as a forum to counter China's regional economic dominance. At the same time, the potential-importance of the TPP may force China to further

reform its domestic economy, and perhaps even to engage in meaningful liberalisation in the RCEP and/or as part of a future APEC-type agreement.

For some, the TPP is divisive and risks pitting Asia-Pacific countries against each other in competing agreements. This view is too blunt, lacking in nuance and reality. The TPP is just one of many regional agreements being negotiated in the Asia-Pacific. Several countries are members of some or all of these efforts. All of the various regional agreements have differing levels of ambition¹⁰ and in this regard they can be viewed as compliments to each other as opposed to competitors.

As a final point, it is worth noting the effect the TPP may have on the future of the multilateral trading system. Some proclaim that the rise of mega-regional trade agreements will relegate the WTO to the periphery. However a more realistic (if optimistic) view is that the rulemaking and innovations created in the TPP and other agreements will eventually be codified into the multilateral system. As discussed earlier, this appears to be the US strategy. A potential benefit of the current stagnation at the multilateral level is that FTAs can be used as test tubes, with the information garnered from successful and failed negotiating positions, rulemaking and innovations used in future multilateral negotiations.¹¹

Conclusion

The entry of Canada, Mexico and most importantly Japan to the TPP has radically changed the negotiating dynamics and potentially the long-term success of the agreement. The TPP has the potential to be a real game changer economically and politically for the Asia-Pacific and more broadly, given that much of the final text of the TPP will be replicated in other FTAs and perhaps even in multilateral forums. This being said, the success of the TPP is by no means a certainty. Protectionist interests in the US and elsewhere can still regain sway with the Administration/Government and Congress/Parliament, while Japanese Prime Minister Shinzo Abe's genuine attempt at domestic reform (of which the TPP features prominently) could easily be defeated by strong lobbyists and conservative politicians (regardless of party affiliation). Meanwhile, Canada and Mexico could adopt a defensive negotiating posture, seeking

not so much as to increase access to partner country markets but to preserve their preferential positioning in the US market. These risks, however, are now balanced by significantly more attractive gains on offer from the successful conclusion of the TPP.

¹ The economic statistics cited in this commentary are sourced from Peter A. Petri, Michael G. Plummer and Fan Zhai, “The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment” East-West Center Working Paper No. 119, 24 October 2011, available at: http://www.usitc.gov/research_and_analysis/documents/petriplummerzhai%20EWC%20TPP%20WP%20oct11.pdf.

² The US ‘pivot’ or ‘rebalancing’ to Asia involves economic, diplomatic, military and other facets. See Remarks by President Obama to the Australian Parliament, 17 November 2011, available at <http://www.whitehouse.gov/the-press-office/2011/11/17/remarks-president-obama-australian-parliament>. See also comments from Secretary of State Hilary Clinton in November 2011: ‘One of the most important tasks of American statecraft over the next decade will therefore be to lock in a substantially increased investment – diplomatic, economic, strategic, and otherwise – in the Asia-Pacific region.’ Hilary Clinton, ‘America’s Pacific Century’, Foreign Policy, November 2011; Hilary Clinton, ‘Remarks on Regional Architecture in Asia: Principles and Priorities’ East-West Center, University of Hawaii, 12 January 2010, available at <http://www.state.gov/secretary/rm/2010/01/135090.htm>.

³ Remarks by President Obama in the Meeting with the Trans-Pacific Partnership, 12 November 2011, available at: <http://www.whitehouse.gov/the-press-office/2011/11/12/remarks-president-meeting-trans-pacific-partnership>.

⁴ In his press statement announcing Japan’s entry into the TPP, Prime Minister Shinzo Abe stressed the need for domestic reform and indicated that Japan would engage in meaningful liberalization. Press Conference by Prime Minister Shinzo Abe, 15 March 2013, available at: http://www.kantei.go.jp/foreign/96_abe/statement/201303/15kaiken_e.html: ‘If Japan alone should become inward-looking, we would have no chance for growth. Companies would not invest in Japan then. Talent would not be attracted either. The TPP is a framework which promises “prosperity in the future” in the Asia-Pacific’ and ‘The significance of the TPP is not limited to the economic impact on our country. Japan is creating a new economic zone with our ally, the United States. Other countries who share the universal values of freedom, democracy, basic human rights, and the rule of law are joining. I firmly believe that creating new rules in the Asia-Pacific region with these countries is not only in Japan’s national interests, but also certain to bring prosperity to the world. Furthermore, I have no doubt that deepening economic interdependence with these countries in a common economic order will significantly contribute to the security of our country and also to the stability of the Asia-Pacific region.’

⁵ American Enterprise Institute, ‘Game changer: Japan and the Trans-Pacific Partnership Agreement’, panel session, held on 15 May 2013, available at: <http://www.aei.org/events/2013/05/14/game-changer-japan-and-the-trans-pacific->

partnership-agreement/?utm_source=Paramount&utm_medium=Event&utm_campaign=game-changer-japan-and-the-tpp

⁶ It should be noted that as part of the process leading to Japan's entry into the TPP negotiations, it entered into bilateral consultations with the US and reached an agreement covering market access for automobiles and insurance, a range of non-tariff barriers and a commitment to support a 'high-standard agreement'. See USTR, 'Towards the Trans-Pacific Partnership: U.S. Consultations with Japan' Fact Sheet, 12 April 2013, available at: http://www.ustr.gov/sites/default/files/04132013%20Japan%20OVERVIEW%20factsheet%20FINAL_1.pdf; USTR, 'Non-Tariff Measures: US Consultations with Japan' Fact Sheet, 12 April 2013, available at <http://www.ustr.gov/sites/default/files/04132013%20Japan%20NON-TARIFF%20MEASURES%20factsheet%20FINAL.pdf>. The US did not require Japan to unilaterally agree to eliminate all of its tariffs upon joining the TPP. See 'Obama-Abe Meeting Sends Signal on Possible Japan TPP Entry' 17(7) Bridges Weekly Trade News Digest, 27 February 2013.

⁷ An example of the controversy is the issue of pharmaceutical patents, with lobbyist and negotiating parties advocating for stronger commitments while others demand more flexibility. See Doug Palmer, 'U.S. Struggles with Pharmaceutical Goals in Asia Trade Talks' Reuters, 28 March 2013, available at <http://www.reuters.com/article/2013/03/28/us-usa-trade-pharmaceuticals-idUSBRE92R10420130328>.

⁸ In this regard, Assistant US Trade Representative Wendy Cutler recently noted that Japan had been 'a good negotiating partner' in both negotiations to update the IT Agreement and the agreement to expand trade in services. She continued, 'Based on all of this, and based on our continued cooperation with Japan, we think that in many areas of the TPP—not limited to but in such areas as IPR [intellectual property rights], services, investment, and customs issues—they will be a very strong partner in the TPP.' Len Bracken, 'USTR Official Sketches Challenges, Potential in Japan Joining TPP Talks' BNA International Trade Daily, 15 May 2013.

⁹ See, i.e., Shanghai Agriculture Committee, 'The dynamics of TPP negotiations and China's Countermeasures', 2011, Zhao Junhua, *World Agriculture* 2011(2), available at http://e-nw.shac.gov.cn/wmfw/hwzc/hygl/201108/t20110812_1300282.htm: stating the TPP is, among other reasons, being negotiated to dilute China's influence; Xie Tian, 'The Key to TPP', *New Epoch Weekly* 251, 2011, available at <http://epochweekly.com/b5/253/10117.htm>: stating that US efforts to negotiate the TPP is retaliation against China for 'withholding economic benefits to the Western countries'; China Review News, 'TPP: US's new leverage on China', 2011, available at: <http://www.chinareviewnews.com/doc/1019/0/5/0/101905072.html?coluid=73&kindid=7151&docid=101905072>: stating TPP negotiations are to 'check and balance China's dominance in the unification of the East Asian economy, minimizing China's economic influence in the East Asian region and suppressing its strategic developmental opportunities in East Asia' and that the 'TPP will have very notable adverse effects on the Chinese economy, as it will usurp China's export market, creating a decrease in exports and thus

create unemployment problems and thus affect the long-term economic development ... TPP may even bring challenges to China in security issues in the East Asian state of affairs.'

¹⁰ Some commentators in China realize the standards of the TPP is not suitable for China – see, i.e. Chen Deming, '(China) will not participate in TPP for now', ifeng.com, available at: http://news.ifeng.com/mainland/special/2012lianghui/detail_2012_03/07/13027378_0.shtml; Shen Minghui, 'Trans-pacific Partnership Relations: US should Cooperate with East Asia', available at: <http://iaps.cass.cn/upload/2011/02/d20110228103257127.pdf>.

¹¹ See Claude Barfield, 'The realist view of the future of the world trading system' Real Clear Markets, 1 May 2013, available at: http://www.realclearmarkets.com/articles/2013/05/01/a_realists_view_of_the_global_trading_system_100293.html

The Trans-Pacific Partnership (TPP): A Trade Trojan Horse?

Dr Stephen Grenville*

On the surface, the Trans-Pacific Partnership (TPP) appears to be a simple example of the fundamental rule of free trade: in trade, imposing or encouraging lower trade barriers is unambiguously a good thing; the lower the barriers, the better.

However, the TPP is much more than a simple free trade agreement, going further to include issues such as labour regulation, intellectual property rights, investment procedures and policies regarding state-owned enterprises. These ‘behind-the-border issues’ are inserted into the format of a trade agreement, like the soldiers hidden in the innocent-looking Trojan Horse.

Before Australia signs the TPP, officials should carefully consider the ramifications of these issues, especially China’s exclusion from current negotiations.

The Golden Rule of Trade Negotiations

Trade negotiations, for all their mind-numbing detail, have one simplifying aspect that guides negotiators: it is always better to lower your tariffs. All participating countries benefit.

Because of this, there is no danger of giving away too much when you agree to lower your tariffs or trade barriers. It sounds like a morality tale: “Yea verily I say unto you, my brethren, that whosoever giveth away much in trade negotiations, to their country much shall be given.” The starting point for negotiations is Thomas Friedman’s ‘golden straitjacket’¹ which argues that countries should sacrifice some economic sovereignty to global institutions.

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The rules on trade are easy: loosely speaking, there should be no rules, or at least no restrictions. In essence, international trade should be free. One of the few things on which economists agree is that free trade is a ‘Good Thing’. With a few minor caveats, economists agree that lowering trade barriers will deliver increased welfare to a country, *even if other countries do not follow suit*. In this bargaining environment, how could one make a mistake?

Anyone who is a spectator of the decade-long inconclusive Doha Round conducted by the World Trade Organization (WTO) might doubt the existence of such a simple rule: the more you give away in the form of trade restrictions, the better off your country will be. The WTO mindset and negotiation model disguises this, as it is based on negotiating reciprocal tariff reductions based on the principle of ‘I’ll lower mine if you lower yours’. This is about politics, not economics. I might be able to extract an even greater advantage if, in return for lowering my own trade barriers, I persuade you to reduce yours as well. Economists support these negotiations not because we support such tit-for-tat bargaining, but because we believe that whatever restriction-lowering outcome that can be forced through the political system will be economically beneficial for all parties.

The Trans-Pacific Partnership and Market Access

The TPP had a low-key beginning as a high-quality agreement (i.e. demanding in terms of trade openness) between Singapore, Brunei, Chile and New Zealand. From this humble beginning, the idea was appropriated by President G.W Bush and now, with the recent addition of Japan, the TPP covers 12 negotiating states. It has always been envisaged that it would set the bar high on free trade: New Zealand initially opposed Canada joining the TPP because of Canadian dairy protection. Currently it is presented as the new ‘platinum standard’ of free trade agreements, but as membership increases, it is inevitable that the TPP’s standards will weaken. Once one member is allowed some ‘exclusions’ for sensitive issues, then every country will want to do the same.

Improving market access is obviously unobjectionable. This aspect seems to be an advance on the so-called free-trade agreements (FTAs), which are

really preferential trade agreements (PTAs), with trade-diverting discrimination against countries not party to the FTA. The TPP offers some hope for over-riding the tangled noodle-bowl of PTAs and regional arrangements. It is big enough to make trade-diversion a lesser problem, covering 38% of global GDP and 25% of global trade. Given the comatose state of multilateral negotiations in the Doha Round, a different trade-enhancing strategy is required with a smaller group of players.

The Trans-Pacific Partnership and Behind-the-Border Issues

The TPP, however, is about much more than lowering tariffs and restrictions. In fact lowering tariffs is a minor component embedded within a broader agreement delineating rules for a range of ‘behind-to-border’ issues such as intellectual property rights, foreign investment procedures and business conduct. In some cases, ‘behind-the-border’ issues may now be more important than tariffs (which are now quite low in most countries). Trade may be restricted by bio-security, codes, standards and the huge range of regulations and requirements which confront foreign products arriving in any country. For these issues, there is no longer a presumption that you cannot make a negotiating mistake by giving away too much. The grim reality is that the standard adopted is usually that of the largest negotiator and the likelihood is that the rules for these issues will mainly be written by the largest player in the negotiations, and will understandably be written in its favour. In these circumstances it is important that negotiations be transparent and conducted without false deadlines to force hasty decision.

The TPP endeavours to set down standards for a number of ‘behind-the-border’ issues including:

- Labour regulations;
- Intellectual property rights;
- Investment procedures;
- Competition policy, including codes of conduct for State-owned enterprises (SOEs).

Each of these regulatory topics obviously impinges on, or is related to, trade. Each makes sense when taken in isolation.

The collapse of a clothing factory in Bangladesh in April 2013² is a tragic reminder that labour standards are too low in some countries trading in international markets. These low standards give Bangladesh a competitive advantage in trading with the world. Should trading partners then insist that Bangladesh has the same labour standards that apply in Australia and the US? Looking at this issue from the viewpoint of competitive neutrality, one might argue that Bangladeshi manufacturers should be subject to the same standards, otherwise other clothing manufacturers would be at a competitive disadvantage. But most people would think that this would be taking the argument too far. Part and parcel of Bangladesh's competitive advantage is cheap labour: that is, that it is not lumbered with the same high standards that rich countries impose.

Although it may not be clear just where the line should be drawn, it is clear that it is not appropriate to impose advanced-world labour standards and regulations on Bangladesh. The TPP does not try to do so. But it will try to impose some labour standards and, unlike trade barrier negotiations, the negotiation of these standards does not follow a single clear guideline. What is appropriate for one country may not be appropriate for another. Thus there will be serious and justified arguments about the rules imposed by the TPP, which will be non-optimal for some countries' circumstances.

Intellectual property (IP) rights raise perhaps the most vexed issues. Many economists are uncomfortable with the way IP rights create economically inefficient monopolies. Of course economists accept that those who invent things should get some reward. They have a moral case. More important still, from an economic viewpoint, the reward should be structured so as to encourage the march of technological progress. This raises the question of how and to what degree investors should be compensated. Giving them a monopoly clearly slows down progress because it stops others from adapting and building on their idea to make it better. Isaac Newton said that, if he saw further than most, it was because he stood on "the shoulders of giants". IP monopolies stop the next generation of innovators from standing on the shoulders of those who came before.

Sometimes there may be no practical alternative to rewarding innovation by offering a legally enforceable monopoly. But this idea has been perverted and misused by IP owners for their commercial interests. For example, the

Disney Corporation persuaded the US Congress to extend the Disney copyright for 70 years after Walt's death in the Copyright Term Extension Act (popularly known as the "Mickey Mouse Act"); agreements such as this are not appropriate incentives for innovation. There are plenty of other valid complaints about IP and the 'ever-greening' of patents. In trying to set a reasonable balance between owners of IP and users, policy-makers should consider whether it is in Australia's interest to have the set of rules decided by the interaction of various American lobby-groups in the US, such as Hollywood versus Silicon Valley.

There is an extra element in this debate. It is difficult for Australia's negotiators to get an appropriate answer when the negotiations are bundled up in a gleaming package, with all the political pressures to 'get with the strength' and not stand in the way of a 'platinum-standard' agreement. I recall how the Australia-United States FTA negotiators essentially had to reach an agreement; if not, the then-Prime Minister would have had to admit that he was not as good a 'mate' of the US President as he wanted the public to believe.³ Such an environment encourages bad deals.

In addition to labour guidelines and international property rights, the TPP also endeavours to regulate inter-country investments. Trade agreements routinely have some provision covering investment procedures; essentially, these say that a country should treat foreign investors as well as it treats domestic investors. However, various things can go wrong with this simple idea. Australia has, rightly, become jaundiced about these clauses based on the behaviour of an international cigarette company (Phillip Morris) that is upset about the introduction of strict packaging rules. Phillip Morris has taken legal action against Australia based on a trade agreement that Australia has with Hong Kong. If the US were serious about including such clauses in international agreements, US officials should have a quiet word with Phillip Morris' management. In the meantime, Australia should not willingly sign up to trade agreements when investment clauses are abused in this way. Innocent clauses, aimed at the highest of goals with the best of intentions, can and will be misused.

These behind-the-border issues are inserted into the format of a trade agreement, like the soldiers hidden in the innocent-looking Trojan Horse.

Our negotiators will need all their guile, and help from other participants, in order to achieve a beneficial outcome.

The Exclusion of China

Perhaps the most striking issue with the Trans-Pacific Partnership is China's exclusion from the agreement. China is not one of the current participants in the negotiations and it is universally assumed that China will not be an inaugural member. Supposedly, this is because China may not want to meet the requirements on State Owned Enterprises (SOEs) for environmental protection and business conduct. Many assume that this exclusion is intended by the US as part of a process of containing China. Several American officials have denied this, stating that China will be welcome when it is ready to agree to the entry conditions. However, it will be much harder to join later when the new member has to sign up without any opportunity to soften any of the conditions through exclusions.

The purported stumbling block relating to SOEs is unconvincing, as other countries such as Vietnam must have the same issue. In any case, it is hard to determine what exactly is so objectionable about SOEs' conduct. International trade should not be given special subsidies, and the SOEs are often the vehicle for this to occur in China; however, it would be wiser to focus on the subsidies themselves, rather than the SOEs (after all, we see plenty of subsidies in 'free-market' economies). China will probably move towards a model that gives a larger role to the private sector over time. Given that the private enterprise model, at least as practised in Europe and the USA over the past five years, has not been flawless, China may consider that it is getting along pretty well with an SOE-based model and would not want to adopt a new free-enterprise model, particular under duress. China is getting a head start on the West in its investment in Africa and the Middle East, in part because its SOEs are prepared to take a risk in pursuing China's national interest. This is not necessarily something to criticise.

China's absence from the TPP does matter. China is the world's largest international trader and Australia's largest trade partner. Does excluding China help in the effort to make China a 'responsible stakeholder'?

Looking forward, China's exclusion from negotiations needs urgent clarification. Unless a way can be found to signal that there is a realistic prospect of China joining and that China would be welcome to do so, Australia must recognise that this will be seen by China as containment. Is this Australia's intent? Clearly, there is still much to be sorted out before Australia can comfortably sign up to the TPP.

¹ For further reading, see Thomas Friedman, *The Lexus and the Olive Tree*, Farrar, Straus & Giroux, 1999.

² Ben Doherty, 'Owner forced workers into doomed factory', *The Age* (25 April 2013), available online: <http://www.theage.com.au/world/owner-forced-workers-into-doomed-factory-20130425-2igy.html>

³ Tim Colebatch, 'Why Latham Should Reject the FTA', *The Age*, 20 July 2004, available online: <http://www.theage.com.au/articles/2004/07/19/1090089093287.html>

The Challenge Facing Asia's Regional Comprehensive Economic Partnership

Dr Jayant Menon*

Introduction by Professor Peter Drysdale**

Introduction

Professor Peter Drysdale

[...]

In Asia and the Pacific there appears to be an economic and geopolitical contest between the TPP (ordered around the United States and its agenda for economic engagement with Asia but excluding China) and RCEP (ordered around the ASEAN+ trade arrangements and China's interest in regional integration but excluding the United States). How these arrangements evolve over time is another thing altogether, but it is clear that should either or any of them be put in place soon, it would prompt a major re-think of what to do in the WTO. Some see the RCEP and the TPP as a competition for a template for trade rules in the vacuum that the WTO has left. That is a priority issue for consideration by global leaders in the G20.

Whether these mega trade deals can be achieved on the schedules that have been announced or whether they will in the end fulfill the ambitions that have been claimed for them is quite problematic. The TPP has already missed two deadlines and is most probably going to miss its next (of October this year).

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There is growing anxiety among the RCEP partners that the 2015 deadline is unrealistic and acknowledgement that the negotiations have so far gone virtually nowhere. There is a sense of despair about the negotiations and the unproductive way in which they are being pursued.

[...]

Currently, RCEP is being pursued in the same way as preferential trade agreements. The intended coverage is similar to so-called 21st century trade agreements, covering trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and other issues. In many ways, RCEP seems to be modelled on the potential TPP that is being pursued by the United States and its partners. Indeed, RCEP is perceived by many as an alternative to the TPP project. In this view, both seek to create trading blocs that include economies accounting for a very significant share of global output and trade.

A more productive strategy is to see a streamlined trade agreement as one of the several steps that will be needed for an RCEP that embraces a more comprehensive program of regional economic integration and development. That would parallel the strategy for creating the ASEAN Economic Community (AEC). Upgrading of the ASEAN Free Trade Agreement (AFTA) of the 1990s to the more comprehensive ASEAN Trade In Goods Agreement (ATIGA) was one of the first steps taken to implement the AEC, alongside a broader program including work to implement the Master Plan for ASEAN Connectivity. Negotiating an innovative umbrella FTA among RCEP participants can be pursued in parallel with the many other steps needed to achieve deeper economic integration and development goals.

Asia's Regional Comprehensive Economic Partnership

Dr Jayant Menon

The first round of negotiations to establish the Asian Regional Comprehensive Economic Partnership (RCEP) — a free trade agreement (FTA) across ASEAN+6 (the 10 ASEAN members plus Australia, China, Japan, South Korea, India, and New Zealand) — was held in Brunei in May.

The RCEP is one of a series of mega-regional trade agreements currently under negotiation including the Trans-Pacific Partnership (TPP) and the US-EU FTA (the Transatlantic Trade and Investment Partnership), officially launched at the G8 meeting in Northern Ireland on 17 June. If implemented, RCEP could create the world's largest trading bloc with potentially significant economic gains for the countries involved. Also significant, in the geopolitical battle to shape the future of regional trade rules and standards, RCEP includes China but not the US.

The RCEP faces some key challenges if it is to live up to its potential. Details remain sparse, but what we do know from RCEP's Guiding Principles is that it will add to, rather than replace, existing ASEAN+1 FTAs, while at the same time introducing 'significant improvements' over these agreements. There is, however, an important qualifier in the dreaded 'flexibility' clause: 'RCEP will include appropriate forms of flexibility including provision for special and differential treatment, plus additional flexibility to the least-developed ASEAN Member States'.

Flexibility could be a boon or bane for the RCEP. While it could help break deadlocks and protect disparate national interests, it could also limit change or curtail progress in achieving greater liberalisation. Indeed, there is much to negotiate — and many breakthroughs needed — if RCEP is to supersede existing agreements.

The existing five ASEAN+1 and twenty three ratified bilateral FTAs vary greatly in terms of almost everything up for negotiation. One example is rules of origin (ROOs), which determine the country of origin of products

and in turn their eligibility for preferential treatment in international trade. There are at least 22 different ROOs among ASEAN+1 FTAs, even after aggregating those that are similar but not the same. Only about 30 per cent of tariff lines across the ASEAN+1 FTAs share common ROOs. With bilateral agreements — the Japan-India FTA for instance — there are 12 types of ROOs, seven of which are unique from the ASEAN+1 FTAs. The sheer number of ROOs — and their lack of commonality across FTAs — will make the task of harmonising and consolidating them that much harder.

Proponents of FTAs argue that deeper agreements can be achieved more rapidly on difficult issues when there are only a small number of negotiating partners involved. But many advocates fail to explain how this principal works within the context of FTA consolidation, where parties are essentially reversing the negotiations process and adding more countries. If access to a bigger market is the lure, then wouldn't the Doha Round be a better, if not easier, process? It may be better. But we know it is not easier. In truth, consolidation may be just as difficult, if not more difficult, than simply starting from scratch. Getting a pair of countries to agree on a specific set of terms will not necessarily facilitate similar breakthroughs with third parties. To ignore this is to ignore ground realities and the political-economy of FTA negotiations. And anyone who has looked closely at an FTA will know how difficult the task of enmeshing even two similar agreements can be, let alone many different ones.

But consolidate they must, if a RCEP is to eventually emerge. The question is how and what form it will take. Pursuing harmonisation while retaining flexibility is likely to produce one of two outcomes. Because harmonisation implies consensus, it could result in a 'race to the bottom', where the lowest common denominator rules. Alternatively, countries taking advantage of flexibility could result in a conservative approach that preserves the current 'noodle bowl'. These outcomes are more likely than the hoped-for 'race to the top' scenario, unless incentives are provided to overcome pressure from the vested interests that lobbied for different ROOs to begin with. The very existence of so many ROOs and exemptions confirms the power of such lobbies. Breaking through these pressures will not be easy, and will require a stronger commitment to reform from all members, big or

small, strong or weak. The problem is that some countries may not see any carrot — and there is no stick.

If a race to the bottom or minimal change comes about, then the RCEP will be largely redundant. Although cumulation rules may expand through increased membership, this usually amounts to little when product fragmentation trade is significant. Changing the type of ROO is more important, but also more difficult. The South Asia Free Trade Agreement (SAFTA), a failed attempt at consolidation, illustrates this. Most trade within South Asia continues under more generous bilateral FTAs or under most favoured nation (MFN) rates. Sadly, SAFTA's main contribution has been to add another strand to the global spaghetti bowl.

Will the same fate befall RCEP? Unless there is enough political will to close potential loopholes disguised as 'flexibility' and pursue reforms deeper than those ever before attempted, RCEP's future as a consolidated bloc remains uncertain. RCEP faces many challenges but this is the fundamental one. A meaningful RCEP will require resolve similar to that which gave birth to the European Union — an example of successful FTA consolidation if nothing else. Unless this happens by its looming 2015 deadline, RCEP may be seen as serving the geopolitical interests of a few players, to little economic effect. Then it will not be 'the economy, stupid', but just politics as usual.

Biographies of Contributors

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Bryan Mercurio is a Professor, Associate Dean (Research) and Vice-Chancellor's Outstanding Fellow at the Faculty of Law at The Chinese University of Hong Kong. He is a specialist in international economic law, with particular expertise in WTO law, free trade agreements and the intersection between international trade and intellectual property law.

Prior to relocating to Hong Kong in 2007, he spent five years at the University of New South Wales, where he a Senior Lecturer and the Director of the International Trade and Development Project at the Gilbert + Tobin Centre of Public Law. He was a Member of the Founding Committee and Executive Board of the Society of International Economic Law, and remains a founding member of the Asian International Economic Law Network and a Member of the Asian WTO Research Network.

Dr Stephen Grenville

Dr Grenville is a Visiting Fellow at the Lowy Institute for International Policy and works as a consultant on financial sector issues in East Asia. Between 1982 and 2001 he worked at the Reserve Bank of Australia, for the last five years as Deputy Governor and Board member.

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Peter Drysdale is Emeritus Professor of Economics and the Head of the East Asian Bureau of Economic Research and East Asia Forum at the Crawford School of Public Policy at the Australian National University. He is widely recognised as the leading intellectual architect of APEC. He is the author of a number of books and papers on international trade and economic policy in East Asia and the Pacific, including his prize-winning book, *International Economic Pluralism: Economic Policy in East Asia and the Pacific*. He is recipient of the Asia Pacific Prize, the Weary Dunlop Award, the Japanese Order of the Rising Sun with Gold Rays and Neck Ribbon, the Australian Centenary Medal and he is a member of the Order of Australia.

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He currently serves as a Board Director of the Cambodian Development Resource Institute. He is the author or co-author of more than 50 refereed publications, primarily in the areas of trade and development.

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