Trans-Pacific Partnership: the good, the bad and the ugly

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Abstract

The Trans-Pacific Partnership (TPP) Agreement aims to be a high-quality, 21st century economic agreement. Yet there are signs that the quality of the agreement may fall short of expectations in respect of market access and tariff elimination provisions with exclusions from previous agreements being carried over into the TPP. And there are areas, such as services trade liberalization, where the TPP could be more ambitious. The 21st century nature of the TPP has meant new issues are being negotiated as well as previously difficult issues being strengthened. Yet it is not clear that all elements are in the interest of all participants. Some aspects of the TPP, if not designed well, could be punitive for developing countries for not having, at the beginning, developed country institutions or standards. Imposition of those standards or institutions does not mean that they are suited to the country-specific circumstances or that developing countries can leapfrog stages of development. There are also aspects that could be damaging to potential TPP members and the region more broadly. There is evidence that strengthening intellectual property (IP) rights provisions in trade agreements is negative sum, not just zero sum, and therefore globally welfare reducing. The United States and other developed countries are net exporters of IP and therefore strengthened IP in the TPP will mean wealth transfers from less developed to more developed countries. Finally, the proposal to ban capital controls for countries, even when faced with a balance of payments crisis, is not in the interest of countries and is not supported by the mainstream literature. Those elements, alongside the fact that the TPP is being negotiated as a single undertaking, recommend a more flexible approach in content as well as implementation timing for any comprehensive agreement that furthers regional economic integration.

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Introduction

The Trans-Pacific Partnership (TPP) Agreement aims to be a high-quality, twenty-first-century economic agreement. It grew out of the P4 grouping from 2006 which comprised Brunei, Chile, New Zealand and Singapore and now has 11 negotiating partners with Australia, Canada, Malaysia, Mexico, Peru, the United States and Vietnam having joined since.

The first round of negotiations since the grouping expanded from the P4 started in 2010 with a subsequent 15 rounds of negotiations having taken place up to December 2012. With close to 30 chapters and so many participating countries, the negotiations are expected to take time. Yet further complications arise with – on top of some usual sensitive areas – some issues that have not been negotiated in trade agreements before, many areas being pushed further than any previous agreement and the fact that the agreement is a single undertaking where everything has to be agreed upon before the agreement is concluded.

The nature of the TPP has meant that new issues are being negotiated as well as some controversial trade issues being strengthened. Yet it is not clear that all elements are in the interest of most participants. This paper looks at some areas currently under negotiation in the TPP that could be more ambitious, some areas that require a cautious approach and raises some questions about whether some elements belong in the TPP at all.

Trade agreements can help liberalise sectors, lock in previous liberalization and be used as a tool to make economies more open and efficient. However, there is a need to be careful when changing domestic regulations that are at the core of the sovereignty of countries, ensuring they are changed for the benefit of the domestic economy, through increased competition or efficiency, and not altered in ways designed merely to secure or increase rents by powerful interests in partner countries with high political leverage.

There are around 30 chapters under negotiation in the TPP and within those chapters there are opportunities for reform that the TPP should strive to deliver on. There are other areas under negotiation that relate to deep domestic institutions and regulations (the reform of state-owned enterprises is a prominent example) that go well beyond the reform of border barriers to commerce. It is possible for domestic reform measures to be progressed in trade negotiations but they require buy-in domestically to be sustained and it may be difficult for countries to sign up to binding, enforceable agreements without first mobilizing complex domestic constituencies for reform. Finally, there are other areas where there are serious questions as to whether they should be included in trade agreements at all, such as the proposed banning of capital controls, and whether their inclusion is mutually beneficial for participating members.

Some chapters under negotiation in the TPP are not controversial and have the potential to reduce trade costs and increase efficiency, or help member countries’ integrate into the regional economy. They include the chapters which aim to improve efficiency in, and standardize, customs procedures; identifying
and removing technical barriers to trade; development, which presumably has a capacity building element to it; and measures to help small and medium sized enterprises. Such measures not only facilitate trade between TPP members but would appear to have the potential to increase economic efficiency in general and facilitate trade between TPP members and the rest of the world. These elements, however, hardly need a preferential trade agreement through which to secure progress. They could alternatively be ‘negotiated’ in an open, non-discriminatory arrangement.

The remainder of this paper highlights the chapters or areas in which the TPP could be more ambitious for it to be a truly comprehensive and liberalizing agreement, and raises questions about other chapters which might benefit some members at the expense of others. The next section looks at areas found in more traditional preferential agreements that could be more ambitious than what is currently being negotiated. Then the paper raises some concerns about other chapters before discussing areas related intellectual property (IP) and capital controls that have the potential to be net welfare reducing. Finally, the paper suggests some features of the TPP that could be modified to add flexibility to the negotiations, before it concludes.

Areas to be ambitious

The TPP aims to be a comprehensive agreement and one of the key tests for how successful it is will be the liberalization achieved in goods trade. The P4 agreement started with the ambitious goal of scrapping all tariffs for Singapore, New Zealand and Chile, with Brunei agreeing to eliminate tariffs on 99 per cent of tariff lines over time (Elms, 2009). That level of ambition appears at risk given the bilateral approach to the tariff liberalization negotiations that the United States has pursued.

The US position that it will exclude from negotiation further market access for countries with which it has FTAs is problematic. That leaves New Zealand, Vietnam, Malaysia and Brunei – countries with which the United States does not have bilateral agreements in place – as the only members with which the United States will negotiate market access. For instance, Australia is pushing for access to the US sugar market which was carved out of the Australia-United States FTA (AUSFTA) but that is off the table in the TPP negotiations because the United States is pushing to maintain strong IPR and services provisions in its current FTAs as well as to avoid opening up negotiations for existing exclusions1.

The US strategy has significant implications. It makes market access negotiations more complex and lengthy, and it makes multilateralization of liberalization much more difficult (Solis, 2011). Australia, Singapore and New Zealand were offering uniform market access schedules to members but there now seems to be a hybrid of bilateral and plurilateral negotiations on market access (Solis, 2011). Bilateral market-access offers may be multilateralized down the track, but that is

1 Inside U.S. Trade, 18 June 2010
by no means assured, and this feature is systemically important as it will affect
the ease with which future members can join (Armstrong, 2011).

There is also difficulty over rules of origin and whether there will be tariff
reductions on goods with components from non-TPP members. One sticking
point between Vietnam and the United States is in the textiles and apparel area,
where the United States wants a strict yarn-forward rule of origin for apparel
which would mean that Vietnamese apparel does not get preferential access to
the US market if its fabrics are imported from non-TPP countries2.

Market access and tariff reductions are areas where the TPP needs to be more
ambitious. The best case scenario would be elimination of all tariffs over time, as
was the case with the P4, and then multilateralization of that liberalization over
time. That way the TPP can be a positive force for broader trade liberalization
and support the non-discriminatory global trading system which has been
weakened by the collapse of the Doha Round.

Services trade is another area where the TPP should be ambitious. There is
potential for an ambitious services chapter in the TPP to become a template for a
WTO plurilateral agreement on services. But thus far the evidence for impetus
from services trade liberalization in preferential agreements has not been
promising. The Australian Productivity Commission’s Report into Bilateral and
Regional Trade Agreements found that FTAs “do not necessarily lead to
significant reductions to services barriers” and the “main impediments to
effective competition” are “regulatory and institutional issues that lie outside the
That is consistent with Francois and Hoekman (2010) who show that there is
zero evidence of services chapters in PTAs having had any impact at all except in
the case of Europe. The reason is that negotiations within PTAs are not
conducive to finding solutions to complex services issues which go beyond the
provision of national treatment and extend deep into a domestic reform agenda.

Despite the evidence that preferential services commitments do not deliver
much in terms of liberalization, some gains can be made by multilateralizing
preferential service-sector accords and this is relatively easy to do with the
preferential accords in place. Achieving gains will be a matter of extending
existing regulatory access to others, whether it is in the area of government
procurement, competition policy or foreign investment restrictions. These are
21st Century trade issues that are important for integration and the equal
treatment of foreign and domestic firms.

Services trade is an area in which there exists potentially large gains from
liberalization—but the gains accrue from opening up competition to domestic
firms, as well as foreign firms, and are therefore not suited to trading
concessions in an international negotiating framework (Dee and Findlay, 2009).
This can be viewed as own-market access, beyond national treatment.

2 Inside US Trade, September 7, 2012
Areas for caution

The P4 agreement originally had an environmental cooperation agreement and a memorandum of understanding for labour which were not enforceable and emphasized member countries working together to promote sound labour and environmental practices (Fergusson and Vaughn, 2011). This formulation preserved the right of member countries to set, administer and enforce their own labour and environmental laws. The United States is known to be pushing for much stronger chapters on environment and labour with the US Congress indicating that it will not pass the implementing legislation for trade agreements without robust labor and environment protections built in, including an enforcement mechanism (Elms, 2009).

While recent US trade agreements (for example with Peru or South Korea) have also stated that environmental regulations and environmental development priorities are the sovereign right of each country, it is the possibility of binding dispute settlement across labour and environmental areas that is potentially difficult for developing countries.

Imposing developed country regulations and institutional structures on developing countries raises the question of whether developing and emerging countries can leapfrog stages of development. It is not realistic to expect developing countries to be able to leapfrog stages of development and achieve developed country environmental and labour standards overnight.

Another example of the imposition of developed country practices, institutions or regulations can be found in the chapter on regulatory coherence. The chapter has the potential to require TPP member countries to establish regulatory coordinating bodies similar to the US Office of Information and Regulatory Affairs for within-country and between-country regulatory coherence (Solis, 2011; Fergusson and Vaughn, 2011). Such goals are worthy but there is a question of whether it is reasonable to expect developing countries to establish well-functioning regulatory coordination bodies that take decades to develop for developing countries (Solis, 2011). The form and functions of regulatory institutions, and best practice, will differ between countries and depend on the historical and institutional context in each country. It is not clear that regulatory cooperation is best achieved in a negotiating context. Best practice principles that are agreed to may be a better way forward than the imposition of particular regulatory and institutional designs from a different context through negotiation.

One area that has been surrounded in controversy is the investor-state dispute settlement (ISDS) mechanism within the investment chapter. The controversy comes importantly from Australia’s policy stance on exclusion from ISDS in any trade agreement, including the TPP. The purpose of including ISDS in an investment chapter is to protect investors from expropriation. Without ISDS or other investment treaty protections, the level of protection that investors receive in host countries depends on the host country legal and regulatory standards. There is no strong evidence that investment agreements that include ISDS
actually increase investment\textsuperscript{3}. Complications arise due to the number of different types of agreements, how much power they give investors, the host country legal protections and the levels of protection afforded in the investor’s home country.

In countries like Australia, for example, foreign companies have significant protections equal to those of domestic firms and there should be no reason to give added protection to foreign investors above and beyond those which domestic firms are afforded. Yet there is a reasonable case for stronger protection if investment takes place in a country where there is a less developed legal regime, a lack of robust institutions to protect the interests of firms or where the rule of law is under-developed.

Caution is required in creating a two-track legal system where foreign firms are afforded greater rights than domestic firms and foreign firms can avoid domestic courts and institutions and directly sue TPP governments through direct investor-state arbitration. Another complication arises when foreign firms can sue governments in the process of their undertaking reforms of their health, environmental or other public policy regulation. There exists the potential to protect investors without impinging on domestic reforms aimed at further liberalization, structural reform or health, environmental or safety regulations.

A recent example that has gained much publicity is in Australia where the tobacco company Philip Morris is suing the Australian government for health laws that require plain packaging of cigarette packs. Philip Morris moved its headquarters from Australia to Hong Kong so that it could sue the government from a Hong Kong base using the framework of the ISDS agreement between Australia and Hong Kong. It would appear that this company is afforded greater rights in Australia than domestic firms, and that these rights might impede the government’s ability to change health regulations. Even if Australia manages an exemption from ISDS in the TPP, given it has investor-state arbitration in some of its bilateral investment treaties, such as with Hong Kong, it may not matter as companies can shift holdings to Hong Kong. If ISDS is included in the TPP there is the possibility that firms from non-TPP member countries can directly sue TPP member governments.

Some aspects of the TPP, if not designed well, could be punitive for developing countries for not having developed country institutions or standards.

**Trade related? Welfare enhancing?**

Intellectual property (IP) rights exist to give innovators incentive to innovate by protecting their right legally to collect monopoly rents on innovations for a given period. Yet there is a balance to be struck between the rights of the innovator and public welfare, since the weaker the IP rights are, the higher is the potential benefit to social welfare as the public benefits from cheaper access to that technology (a patented medicine, for example). Extending copyright or extending

\textsuperscript{3} See, for example, Sauvant and Sachs (2009) for studies with mixed evidence.
patent protections in trade agreements is a very different principle from lowering tariffs. Such protections potentially involve significant welfare transfer between partners where innovations are generated and international users of goods in which innovations are embodied, with unspecified (perhaps unknowable) outcomes on the generation of innovation.

As a result of AUSFTA, Australia strengthened its IP rights regime. While the IP regime protects commercial interests, it is not clear that IP should be a priority in trade agreements and there is insufficient evidence that such measures are welfare enhancing. The United States is a net exporter of IP relative to Australia and so AUSFTA resulted in net wealth transfers to the United States from Australia. There is strong evidence that the IP regime in the United States is tipped too much towards the interests of firms that patent technologies and away from the socially optimal balance, and also some evidence that strengthening IP protection not only does not increase innovation (Lerner, 2009), but also that it might stifle innovation (Boldrin and Levine, 2012). There is an effort to expand the privileges that US companies receive in the United States (and in some of its FTA partner countries), including controversial features of US IP law, to the rest of the Asia Pacific region through the TPP and lock that in as a global norm. There is a growing body of literature that shows, empirically and theoretically, that strong IP protection and patent regimes help to protect incumbent producers maintain monopoly rents and causes less innovation, not more (Boldrin and Levine, 2012).

There is evidence that strengthening IP protections in trade agreements could produce negative, not just zero sum, outcomes and therefore be globally welfare reducing (Deardorff, 1992). There is a lack of evidence that strengthening IP protection in a trade agreement is mutually beneficial for the member countries. By design, such agreements involve a direct welfare transfer from South to North. It follows that any IP provisions should be subject to independent scrutiny and IP should not be included in trade agreements as a matter of course.

There would appear little justification from a social welfare standpoint for including IP in trade agreements. There is the added public policy issue that strengthened IP protection reduces access to generic medicines, both in terms of price and the time to market. Patent linkage, patent term extension and data exclusivity are measures the United States is pushing for in the TPP that would severely limit the ability to supply generic medicine. One outcome of including strong IP provisions for pharmaceuticals in AUSFTA was that it limited the ability to supply generic medicine in Australia (Harvey et al, 2004).

It is in a country’s own interest to strengthen IP protection to a certain degree to give incentive to innovate but the socially optimal level of protection is likely much less than what the United States has or what it is pushing in the TPP. Many countries are pushing not to go beyond the WTO’s TRIPS agreement and in countries such as Australia that have agreements in place (AUSFTA) that already go beyond TRIPS, not to go beyond the domestic protections.
Another area that is on the TPP agenda that could potentially be detrimental to member economies is the provision that aims to ensure unrestricted transfers and payments. That is, there would be provisions that ban capital controls even in the event of a balance of payments crisis. There has been strong opposition to this aspect of TPP by a group of leading economists which argues that

*Authoritative research published by the National Bureau of Economic Research, the International Monetary Fund, and other institutions has found that limits on short-term capital flows can stem the development of dangerous asset bubbles and currency appreciations, grant nations more autonomy in monetary policy-making, and protect nations from the dangers of abrupt capital flight.*

*The U.S. government’s rigid opposition to capital controls does not reflect the global norm.*

The experience of the Asian financial crisis of 1997/98 would seem to make it very difficult for Asian economies to accept limits on capital controls, and it is not in their interest to do so.

**Flexibility**

It is not clear that all aspects of the TPP are in the interest of all members. Some aspects seem to be zero-sum, or even negative sum, and could potentially be damaging to some countries. Yet the TPP is being negotiated as a single undertaking that continues to set relatively close deadlines for completion. That is a potentially dangerous mix as there may be trading off of mutually beneficial trade-related issues against some of those issues that may not be mutually beneficial (or punitive for some members) or at worst globally welfare reducing. For example, would Vietnam strengthen its IP rights above and beyond the level that is in its interest to get duty free access to the US clothing market? Or will it surrender its ability to limit capital controls for the same clothing concessions?

The single undertaking principle was a major difficulty in the WTO’s Doha Round but there are more flexible ways of interpreting the single undertaking that can allow settlement on agreements to be reached (Messerlin, 2007). A single undertaking approach potentially lacks sufficient flexibility to accommodate the diversity of the region with economies at different stages of development. One example is in respect of ISDS where there is insufficient evidence that investor-state dispute arbitration increases foreign direct investment and the difference in protections and regimes across the countries with different development levels begs for a regime with flexibility.

The Regional Comprehensive Economic Partnership (RCEP), another plurilateral trade agreement in the region, appears more flexible towards accommodating membership at different stages of development than does the TPP (Das, 2012).

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4 Re: *Promoting financial stability in the Trans-Pacific Partnership Agreement* 
http://ase.tufts.edu/gdae/Pubs/rp/TPPAEconomistsLetter.pdf
Although the negotiations have only recently started, it would allow different time frames for implementing provisions for developing countries as well as open access to the agreement among its main principles. These principles do not necessarily mean a lower quality agreement but they mean a longer implementation process for developing countries on some more difficult aspects for them to implement (Lim, 2012). It also has the benefit of working from a base of existing agreements in the ASEAN+1 agreements. The TPP started from the P4 but there is now little resemblance in the structure and principles between the TPP and its predecessor (Elms, 2009).

The expansion of membership might be the TPP’s single largest challenge (Armstrong, 2011). The TPP has the potential to complement other positive regional initiatives, in Asia and in the Asia Pacific, and further economic integration and enhance economic cooperation, but it also presents the very real possibility of doing the exact opposite. Like RCEP, the TPP also has as open accession as a principle that it inherited from the P4 but it appears that membership will be very difficult for large developing countries such as Indonesia and China in the near to medium term (Armstrong, 2011; Petri, Plummer and Zhai, 2012). For the open accession clause in RCEP to be effective, RCEP would have to avoid high entry barriers towards which the TPP appears headed.

Expansion of membership is a key for any plurilateral agreement in the Asia Pacific in furthering regional economic integration. The track record of preferential trade agreements in expanding membership has been dismal. A test will be the ease with which countries can accede to the TPP or any other agreement after meeting clear, transparent set of criteria (Armstrong, 2011).

Conclusion

The TPP presents the region with an opportunity to set trade rules and further open up closed markets, as well as make consistent many of the different trade rules and trading regimes in the region. Yet there are some elements of the TPP that appear not to be welfare improving (positive sum or win-win). If not designed well some of those elements could be punitive for developing countries for not having developed country institutions or standards. It is not realistic to expect countries to leapfrog stages of development because of punitive measures imposed from the outside. Furthermore, there appear to be aspects of the TPP that — if included in the final agreement — could be damaging to some member economies. There is evidence that strengthening intellectual property rights in trade agreements could be globally welfare reducing (negative sum) and the proposal to ban capital controls is not supported by evidence in mainstream literature.

There also needs to be some flexibility in the TPP which recognizes that there are differences across countries. Flexibility need not mean lower standards or lower quality for those areas agreed to as mutually beneficial and which are trade liberalizing. It may mean delaying implementation of the standards where
developed country standards would otherwise being imposed on developing countries in a short time frame.

The TPP can act as a catalyst or provide external pressure to lock in domestic reforms but those reforms and rules need to be measures that increase economic efficiency or competition. The TPP has the potential to do the opposite and that scenario is more likely to play out if measures are introduced that move countries towards standards and rules that are more suited to advanced economies and end up being punitive and causing wealth transfers from developing and emerging economies to developed economies. It is not clear that all the 21st century trade issues in the TPP are win-win or trade creating. If USTR succeeds in much of what it is pushing for, the TPP could look like an agreement that has ‘platinum standards’ which are in effect ‘platinum transfers’ to developed countries, most prominently the United States.

References

http://research.stlouisfed.org/wp/2012/2012-035.pdf


