INNOVATIONS AND IMPLICATIONS OF THE TRANS-PACIFIC PARTNERSHIP AGREEMENT

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ABSTRACT

Twelve Pacific Rim countries that account for forty percent of world output and more than a quarter of world trade have signed a Trans-Pacific Partnership (TPP) agreement. Assuming that the agreement is ratified and implemented by the signatory countries, the TPP will have important implications for the world trading system. New ground is broken in this mega-regional agreement in a number of areas where progress has not yet been possible in the more comprehensive World Trade Organization negotiations. This paper provides an analysis of the innovations in the agreement, assesses their significance for the broader world trade regime, and considers the feasibility of extending them to the multilateral trading system. Synergistic effects on other ongoing mega-regional negotiations are also considered.

Keywords:
Trans-Pacific Partnership; trade policy; regional trade agreements; world trading system
2. INTRODUCTION

On 4 February 2016, twelve Pacific Rim countries signed the Trans-Pacific Partnership Agreement (TPP). Signatories of this agreement include the United States and Japan, two of the three largest economies in the world. Together the twelve member countries account for approximately forty percent of world Gross Domestic Product (GDP) and twenty-six percent of global trade, making this potentially the largest regional trading agreement to date. It is a comprehensive agreement, addressing a wide range of trade-related issues, comprising thirty chapters and 5,000 pages. The agreement will enter into force whenever it has been ratified by all of the signatory countries if that happens within two years. If not all countries ratify the agreement within the two year period, it will enter into force after being ratified by at least six countries accounting for at least eighty-five percent of the combined GDP of the signatory countries.

2. BACKGROUND

The Trans-Pacific Partnership Agreement is the outgrowth of a much smaller agreement among Brunei, Chile, New Zealand and Singapore, the Trans-Pacific Strategic Economic Partnership Agreement that was signed in 2005. In 2008 the United States joined first the financial services and investment negotiations, and later the same year entered into comprehensive negotiations. Also in 2008, Australia, Peru and Vietnam were invited and joined. Malaysia was invited to join in 2010, as was South Korea. Malaysia elected to join the negotiations but South Korea declined. The significance of the TPP was greatly enhanced by Japan’s decision to join the negotiations in 2012. The twelve signatory countries are the United States, Japan, Singapore, Brunei, New Zealand, Chile, Australia, Peru, Vietnam, Malaysia, Mexico, and Canada.

Motivations for the agreement were both economic and geopolitical. Progress toward trade liberalization at the multilateral level through the Doha Round negotiations had stalled. Before the Uruguay Round agreements of the 1990s, multilateral trade negotiations had been dominated by the United States, Canada, the European Union and Japan, with the least developed countries free-riding on the trade liberalization and little being demanded of them. That dynamic changed when the Uruguay Round agreements were presented as a “single undertaking,” with all members

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1 “...the GATT was all about exchanges of market access, so market-size was the coinage of the realm. In the GATT period, the United States, European Union, Japan, and Canada—known as the Quad—dominated on this metric, accounting for two-thirds of world imports” (Baldwin, 2016: 107).

2 “For most of GATT’s history, developing countries played only a marginal role, with few concessions made and few gains received. The domination of the US and its Western allies, in the GATT multilateral trade negotiation was challenged for the first time in the Uruguay Round. (Liang, 2016: 400). See also, Narlikar (2003).
of the newly-formed World Trade Organization expected to abide by all the provisions. Since that time, the number of effectively participating players in world trade talks has increased greatly, making agreement at the multilateral level extremely challenging. Instead, trade liberalization during the past fifteen years, which has been very significant, has occurred at either the unilateral or regional levels (Baldwin, 2016). That being the case, mega-regional agreements such as the TPP have great appeal. Not only are they viewed as the most effective way to achieve significant liberalization, but also are viewed as a way to begin crafting rules in new areas that could eventually serve as a template for global trade and investment relations within the multilateral framework.

On a geopolitical level, the United States has gradually come to realize the growing importance of Asia on the global stage. In terms of economic growth, Asia is the most dynamic region of the world. China’s growing economic and political weight has raised concerns in both the United States and in China’s neighboring countries, particularly after China’s provocative projections of military activities and sovereignty claims in the South China Sea. Partly for this reason, the Philippines, Thailand, Taiwan, South Korea and Indonesia have all expressed interest in possibly joining the TPP, as has Colombia for different reasons. Beyond the anticipated gains from trade and investment liberalization, a major motivation for United States participation in the TPP was to demonstrate its commitment to the Asian region (Dawson, 2015). Membership is potentially open to all 21 of the Asia-Pacific Economic Cooperation (APEC) countries, and to countries outside the region if approved by member countries.

3. STANDARD FEATURES OF THE TPP AGREEMENT

In general, the TPP embodies the usual principles of the World Trade Organization such as nondiscrimination, transparency and reciprocity (Dawson, 2015). However, there are long lists in the annexes to the agreement of nonconforming measures, particularly for services, exempting countries from having to abide by the terms of the overall agreement in specific areas. After becoming embodied in the agreement, these nonconforming measures may be very difficult to unwind and could lead

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3 Between 2006 and 2015, the average annual growth rate of Gross Domestic Product was 8.0% in Emerging and Developing Asia, in contrast to 1.4% in advanced Economies, 3.5% in the Commonwealth of Independent States, 3.1% in Emerging and Developing Europe, 3.4% in Latin America and the Caribbean, 4.4% in the Middle East, North Africa, Afghanistan and Pakistan, and 5.8% in Sub-Saharan Africa (Pasquali, 2015).

4 For example, in the United States, foreign companies cannot acquire oil and gas pipelines crossing federal lands, foreign airlines are restricted from offering domestic air services, and only registered US persons may offer bus or trucking services. In Australia, notification and approval by the government is required for investments in a variety of industries, transmission quotas are permitted for local content on radio and television broadcasts, and patent attorneys must be resident in Australia to offer services there. Japan reserves the right to limit the number of licenses to engage in various types of businesses, and also reserves the right to maintain restrictions on supply of services to broadcasting and space industries (USTR, 20165b).
to similar exclusions for countries acceding to the agreement in the future. Rather than having so many exclusions, liberalization with long phase-in periods where necessary would have been preferred (Scissors, 2015).

With regard to import tariffs, the TPP provides for the eventual elimination of all non-agricultural tariffs, albeit with long phase-in periods for sensitive products. Three-quarters of import tariffs will be eliminated immediately upon implementation of the agreement, as will an estimated ninety-nine percent in the long run (Freund, Moran, Oliver, 2016). Industrial tariffs are relatively insignificant for most products among the economically advanced members of the group, but are significant barriers still in developing countries such as Vietnam. Removal of these tariffs will expand trade with attendant improvements in economic efficiency.

Liberalization of trade in agricultural products is politically difficult in most countries, and for that reason the gains made in the TPP, while significant, are limited. Substantial concessions were made by Japan with regard to soybeans, beef and pork, but not for corn and rice. All of the TPP countries opened up their agricultural markets to some extent. Even though the United States is the world’s largest exporter of agricultural goods, it did little to liberalize its agricultural trade in the TPP. Trade-distortive agricultural subsidies remain in place, as do quotas on sugar. (Hendrix and Kotschwar, 2016) Beef tariffs are phased out only after 15 years, and dairy tariffs only after 30 years. Canada’s highly trade-distortive supply management system for dairy and poultry products remains in place. (Hendrix and Kotschwar, 2016)

Some progress is made in the TPP toward freeing-up government procurement. Most countries have regulations designed to direct government agency purchases to domestic firms. The World Trade Organization’s Agreement on Government Procurement (AGP) that attempts to open government procurement to outside firms is a plurilateral agreement to which only five of the twelve TPP countries subscribe. These five countries did not make significant new commitments in the TPP negotiations. The governmental agencies of the seven countries that do not subscribe to the AGP will be more open to foreign suppliers because of the TPP, although many exceptions are written into the agreement. Little or no progress was made to free up purchases of subnational governmental agencies. Nevertheless, the progress made in the agreement could provide a foundation for further progress in subsequent negotiations, and as additional countries possibly accede to the TPP agreement in the future (Moran, 2016).

International trade in services is an important and growing component of international commerce, especially for developed countries such as the United States and Canada. The TPP agreement provides for considerable liberalization of services trade, particularly in the cases of Japan, Vietnam and Malaysia. Eight of the TPP countries are currently involved in plurilateral negotiations with 15 other countries

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5 Article 24 of the General Agreement on Tariffs and Trade requires that preferential trade agreements remove tariffs on “substantially all of trade” among the participating countries “in a reasonable period of time,” defined generally as not exceeding 10 years (GATT, 1994). One must wonder if a 15–30 year timeframe for phase-in is a reasonable period of time.
(42 if the European Union countries are counted separately) to establish a Trade in Services Agreement that could be completed in 2016. If completed, this agreement would include most of the services trade liberalization agreed in the TPP, but four of the member countries (Malaysia, Vietnam, Brunei and Singapore) are not part of these broader negotiations (Hufbauer, 2016b). A troublesome aspect of the TPP services agreement is that there are extensive lists of nonconforming measures that sometimes negate proposed liberalizations. These particularly hinder liberalization of trade in financial and transportation services (Scissors, 2015).

Modern trade agreements address more than trade, and the TPP is no exception. The agreement has numerous provisions affecting investment, including an investment chapter and a separate chapter on investor-state dispute settlement of investment issues. One of the more important investment provisions is agreement on a ”negative list” for accepting foreign direct investments. This means that economies are open to foreign investments except for those specifically excluded. This will be important as new products and services are introduced. The liberalizations of trade in goods and services, increased transparency of regulatory regimes, and improved intellectual property protections will also all foster cross-border investments (Moran, Oldenski, 2016). There are many derogations from the agreement by specific countries to shelter favored industries, however, that dilute the investment provisions (Scissors, 2015).

Protection of foreign investments through investor-state dispute settlement (ISDS) is a controversial part of the agreement. Critics of ISDS contend that it is a threat to the regulatory authority of governments. The TPP agreement attempts to address these concerns by stating specifically that member countries have the right to regulate for protection of health, safety, environment and cultural diversity. It also puts in place procedures to increase transparency in investment dispute settlement cases, and gives arbitrators the right to allocate costs of ISDS cases as a way to discourage frivolous cases. It also attempts to clarify legal terms such as ”fair and equitable treatment” and “indirect expropriation” that have been subject to varying and sometimes conflicting interpretations by arbitrators in previous ISDS cases (Hufbauer, 2016a).

4. INNOVATIONS IN THE TPP AGREEMENT

While provisions have been included in recent trade agreements to address trade-related environmental concerns, the environmental provisions of the TPP are more extensive than in any previous trade agreement (Schott, 2016). Parties to the agreement have committed not only to enforcing their own environmental regulations, but also to enforcing the terms of multilateral environmental agreements to which they have subscribed. Member countries undertake new obligations to protect biodiversity, prevent illegal trade in wildlife and illegally harvested wood, and to prevent overfishing. Dispute settlement procedures for environmental issues are the
same as for other parts of the agreement, with trade sanctions available as enforce-
ment measures (USTR, 2016b: Article 20.23).

Despite the fact that poorer countries in the agreement such as Brunei, Malaysia, and Vietnam have very different labor markets and conditions than the more eco-
nomically developed member countries, the TPP agreement goes beyond previous free trade agreements in extending protections to workers. Not only do the member countries commit to enforcing their own labor laws, but also to enforcing core inter-
national labor standards as articulated by the International Labor Organization: abolition of child labor, elimination of forced labor, freedom of association and the right to collective bargaining, and no discrimination in employment. The TPP par-
ties commit to establish minimum wages and regulation of working hours, and to the establishment of occupational health and safety standards (USTR, 2016b: Article 19.3). New provisions in the TPP provide for protection of workers in foreign trade zones, and discourage trade in goods produced by forced labor. The language in the agreement is often vague, however, with a lot of regulatory discretion left to individu-
al countries (Cimino-Isaacs, 2016). The labor chapter includes separate agreements between the United States and Brunei, Malaysia, and Vietnam focused on institu-
tional reform and capacity building in these countries to enable them to adhere to the terms agreed. The provisions of the labor chapter are subject to the same dispute settlement procedures as other chapters, with trade sanctions potentially available for enforcement.

The telecommunications chapter of the agreement for the first time specifies network access rules to suppliers of mobile services that should open up competition in this sector, where it is often lacking. It is the first free trade agreement to address the issue of unreasonable mobile roaming rates that can add a significant cost to doing business internationally.

The TPP agreement has several provisions aimed at strengthening the enforce-
ment of intellectual property rights beyond what has previously been agreed. It re-
quires countries to have criminal sanctions for counterfeiting trademarks on a com-
mercial scale, and requires them to have civil penalties that are in accordance with the losses incurred for violation of any of the intellectual property provisions. Since five of the TPP countries are on the United States Trade Representative’s 2016 watch list for having “serious intellectual property rights deficiencies,” these strengthened enforcement provisions would seem to be warranted. 6 They will carry great weight in negotiations with countries such as Indonesia that have indicated an interest in joining the TPP.

Perhaps the most controversial part of the TPP agreement is that addressing in-
tellectual property rights for pharmaceutical products. Nongovernmental organiza-
tions (NGOs), such as the highly respected Doctors Without Borders, have expressed

6 The named countries are Canada, Mexico, Peru, Vietnam and Chile (Chile is on the Priority Watch List) (USTR, 2016a).
serious concerns about how the terms of the agreement might deprive poorer countries of life-saving medicines. There is an ongoing debate about how to balance the conflicting goals of providing medicines at reasonable cost while at the same time leaving adequate incentives for the development of new drugs. There are no easy or certain answers to this dilemma. Dispassionate analysis of the terms of the TPP agreement and existing empirical work indicate that the consequences of the TPP intellectual property provisions will probably not be dire as feared by some, and in fact may have struck a reasonable balance (Branstetter, 2016a). Among other things, the agreement provides 5-year protection of the data submitted to regulatory agencies by pharmaceutical firms to prove the safety and efficacy of a new chemically-synthesized drugs, and 8-year protection for those produced through biotechnology (known as biologics). Pharmaceutical companies wanted 12-year data protection for biologics, while NGOs advocated for 5 years, and the compromise arrived at by negotiators was 8 years. This will delay somewhat the entry of certain generic drugs, but the TPP agreement does not infringe upon existing safeguards that allow countries to override patent rights in case of public health emergencies, and poorer countries in the TPP are permitted to delay implementation of the provisions for up to 10 years, with additional delays possible depending on the circumstances. Other TPP provisions relating to pharmaceuticals are very similar to those of free trade agreements of the United States dating back to 2010. Existing empirical work indicates that these provisions had no adverse impact on drug access or drug prices in the affected countries (Branstetter, 2016a).

Particularly relevant to the 21st Century, and an innovation of the TPP agreement, are provisions dealing with digital trade. A digital good is defined in the agreement as “a computer programme, text, video, image, sound recording or other product that is digitally encoded, produced for commercial sale or distribution, and that can be transmitted electronically” (USTR, 2016b: Article 14.1). Digital trade is growing much more rapidly than trade in physical goods, and most likely will continue to do so. The TPP extends the principle of nondiscrimination generally to digital goods, and prohibits the imposition of import duties on such products. Tariffs can still be applied to physical goods that are purchased online, but not to digital goods. Countries are not permitted to block foreign websites, except for purposes of national security or the protection of public morals. Cross-border data flows are to be unimpeded, and parties to the agreement cannot require that local computing facilities be established as a condition of doing business (Branstetter, 2016b). Many services are traded via digital goods, and the volume of such transactions is underestimated because they are often are not recorded in trade statistics. Given the growing importance of digital trade, the precedents set in the TPP agreement for unrestricted trade in such goods will take on increasing importance as the share of such goods in world trade increases, and as additional countries accede to the TPP.
Another important innovation of the TPP agreement, both for the present and with an eye to the future, is the chapter dealing with state-owned enterprises (SOEs). The provisions in the TPP agreement go beyond commitments on SOEs found either in the World Trade Organization agreements or in other free trade agreements (Miner, 2016). They attempt to discipline the support and protections extended by governments to state-owned enterprises which provide unfair advantages for them in international commerce, such as subsidies and regulations tailored to their benefit. All of the TPP countries have some SOEs, but they are particularly important in Malaysia and Vietnam. Undoubtedly, the SOE provisions of the TPP agreement were written also with the prospect in mind that China might someday apply for membership. The United States and other TPP countries wanted to have rules regarding SOEs established before possible negotiations with China got underway.

SOEs are defined in the TPP agreement as enterprises that are engaged in commercial activities and in which the state has more than 50% direct ownership, controls through ownership interests more than 50% of the voting rights, or appoints a majority of the board of directors (or other governing body). Member countries are to provide a list of all their SOEs or to post such a list on a website, and to provide information on specific SOEs if requested to do so by another member country. SOEs are prohibited from discriminating against the firms of TPP member countries, and their purchases and sales are to be based on commercial considerations. Subsidies to SOEs that harm the firms of TPP member countries are prohibited. The SOE provisions in the agreement are subject to the agreement’s dispute resolution provisions, with trade sanctions available as enforcement measures.

Other innovations in the TPP agreement include a chapter (Chapter 25) on regulatory coherence, the aim of which is to keep regulatory regimes from being protectionist or otherwise trade-distortive. It encourages interagency consultation and coordination, and promotes good regulatory practices such as impact assessment. Chapter 26 of the agreement provides the strongest disciplines ever on transparency and anti-corruption. TPP countries are required to provide readily accessible information about laws, rules and regulations concerning trade and investment within their borders. They are also required to have and enforce anti-bribery laws and to guarantee due process rights. According to the United States Trade Representative, Chapter 27 which deals with administrative and institutional provisions for the first time in a trade agreement requires the member countries to present plans and report on their progress for putting into effect the measures for which transition periods have been agreed.7

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7 “For the first time in a trade agreement, the TPP requires Parties to report on their plan and progress in implementing those measures for which they have negotiated implementation transition periods. These transition periods support the development objectives of the TPP by providing lower-income TPP countries additional time to build capacity in specific agreed areas. Through the reporting requirements, Parties can monitor progress, address problems, and offer capacity building assistance if needed, ahead of the date for final implementation” (USTR, 2016c).
5. IMPLICATIONS OF THE TPP AGREEMENT

There has been an ongoing debate concerning whether regional trade agreements such as the TPP are, on balance, good or bad for the world trading system. Eminent international economists such as Jagdish Bhagwati have argued that they are discriminatory by nature, that they needlessly complicate the international trading system, and that they divert energies and attention from efforts to liberalize trade multilaterally (Bhagwati, 1998). Others, such as C. Fred Bergsten, argue that progress on difficult issues at the regional level can provide a template for progress along the same lines in multilateral negotiations, as the North American free trade agreement seemed to do for the Uruguay Round negotiations during the 1990s. (Bergsten, 1996) Where does the TPP agreement lie along this spectrum?

As delineated in the paragraphs above, the provisions of the TPP agreement break new ground in areas where progress has not yet been possible in multilateral negotiations. While still limited, significant progress was made in opening agricultural markets to increased competition. Market access for other goods and services was also pushed beyond what has been accomplished through the WTO. TPP countries agreed to significant liberalization of their investment regimes. Labor and environmental protections were extended even beyond those of the more advanced regional agreements. Rules designed to keep digital trade unrestricted and to strengthen protections for intellectual property could well provide a template for future multilateral negotiations. Disciplines on the activities of state-owned enterprises go well beyond those of previous regional or multilateral agreements, and very likely will be adopted more broadly in future negotiations. The main goal of international trade agreements is to provide a predictable legal and commercial framework for trade and investment through rules that are mutually advantageous. The TPP agreement makes real progress in that regard.

Nevertheless, there are shortcomings in the agreement that could be stumbling blocks for future trade talks. Being a free trade agreement rather than a customs union, the TPP has rules of origin to prevent trade deflection. The complexity of the rules and the requirement for ninety-percent within-TPP content for duty-free access places a burden on traders, especially small businesses. If and when new members are added to the TPP, the rules of origin will become even more complex. Of course, in multilateral trade talks this would not be an issue since the most-favored-nation principle would prevail and rules of origin would not be necessary. That some firms choose to pay import tariffs rather than go through the trouble and expense of satisfying rule of origin requirements clearly demonstrates their trade-distorting character.

Another troubling aspect of the TPP agreement is the number of nonconforming measures that exempt countries from particular provisions of the agreement. These are particularly onerous for financial and transportation services (Scissors,
The extent of the nonconforming measures allowed make it likely that future members of the agreement will insist on such exemptions as well to protect their preferred sectors.

Also, the very long phase-in periods permitted for removal of restrictions on some agricultural and automotive products detract from the potential benefits of the agreement. While these may have been necessary in politically sensitive sectors for concluding the negotiations, an unfortunate precedent has been set for future negotiations at either the regional or multilateral level.

6. CONCLUSION

On balance, while it is far from a perfect agreement, the TPP agreement should serve as a template for progress on a number of issues in the world trading system. At the very least, it will upgrade and modernize the provisions of the trade agreements that already exist among several of the TPP countries. It seems already to be influencing the negotiations led by China for a Regional Cooperation and Economic Partnership that the participants hope to conclude in 2017. Some of its provisions will likely be adopted in the Transatlantic Trade and Investment Partnership negotiations now underway between the United States and the European Union. A possible blending of these three mega-regional trade agreements (should they come to fruition) sometime in the future could set the stage for the next multilateral agreement under the auspices of the World Trade Organization.
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