

## **The TPP – Opportunity for a New Approach to Services Trade and Investment Liberalisation?**

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The emergence of the Trans Pacific Partnership as a potentially important vehicle for trade liberalization and regional economic integration in the Asia-Pacific has been a striking new development over the past two years in the evolution of the region's trade architecture. The TPP is envisaged by its partners as a "high quality, 21<sup>st</sup> century" trade agreement, and there is a clear ambition to progressively expand the membership of the TPP to include most if not all APEC members. If this ambition is realized the TPP may prove to be a stepping stone to establishment of the Free Trade Area of the Asia-Pacific (FTAAP). TPP negotiations have been proceeding at a rapid pace since March 2010.

The TPP offers thus offers an important opportunity to advance a forward-looking services trade liberalization agenda, something which appears increasingly unlikely to emerge from the WTO's Doha negotiations and which has been achieved only partially and sporadically in the FTAs that make up the Asia-Pacific "spaghetti bowl" or "noodle bowl".

The primary purpose of this brief paper is to provide background on the TPP initiative. A brief chronology of the TPP is provided, followed by discussions of the significance of the TPP, regional responses, and future outlook for the TPP. The paper concludes with a brief discussion of the challenges involved in designing services trade provisions for the TPP that live up to the characterization of the TPP as a "high quality, twenty-first century" agreement.

### **TPP - Brief Chronology**

In September 2008 the United States announced that it would negotiate to join the so-called 'P4' FTA or Trans-Pacific Strategic Economic Partnership (TPSEP). In November 2008 Australia and Perú announced that they too would join negotiations to forge an expanded agreement, which from that time onward has been known simply as the TPP or Trans-Pacific Partnership. In late 2009 President Barack Obama confirmed that the United States would "engage" with the process of shaping the expanded agreement. At that time the TPP was the first significant trade initiative that the Obama

Administration, elected a year earlier, had committed itself to pursue. In March 2010 TPP negotiations formally commenced among the United States, Australia, Perú and the four foundation members of the TPSEP, Singapore, New Zealand, Chile and Brunei, with Viet Nam also participating in the negotiations as an observer.

With the decision by the United States to negotiate participation in the TPP, an initiative previously perceived as a somewhat obscure trade agreement among four small Asia-Pacific economies was transformed into a potentially major element in the development of the Asia-Pacific regional trade architecture. Attention understandably became focused on the potential of the initiative as a vehicle for United States trade and economic policy toward East Asia. It focused also on related questions of how the TPP membership might be further expanded in future to embrace a still wider range of Asia-Pacific economies, and of the structure and content of the agreement that might emerge from the negotiations among the seven or eight participating economies, many of whose bilateral trade relationships are already covered by existing FTAs, including existing bilateral FTAs with the United States in the case of four participants (Australia, Chile, Perú and Singapore).

In March 2010 TPP negotiations formally commenced among the United States, Australia, Perú and the four foundation members of the TPSEP, Singapore, New Zealand, Chile and Brunei, with Viet Nam also participating in the negotiations as an observer. Six TPP negotiating sessions have now been held, the most recent in Singapore at the end of March 2011. At the third session, in October 2010, Malaysia announced that it would join the negotiations as a full participant, and Viet Nam is also now a full participant in the negotiations. Negotiating groups have been established to address a wide range of issues, including industrial goods, agriculture, textiles, sanitary and phytosanitary standards, services, investment, financial services, intellectual property, regulatory coherence, the environment, competitiveness, supply chain development, and small- and medium-sized enterprises, among others. Draft texts have been developed for many of the proposed chapters of the agreement, and the process has begun of exchanging market access requests and offers. Agreement has been reached that services offers will be made on a negative list basis. Progress is being made in discussions to develop a TPP rule of origin.

The sixth round of TPP negotiations, held at the end of last March in Singapore, was widely seen as the point at which the negotiations would have to switch from consideration of generalities to hard bargaining over specific issues, with draft texts for a number of sections of the agreement expected to be tabled and discussed. Perhaps unsurprisingly, comments emerging from those negotiations suggest that the outcome was neither as positive as the optimists had hoped, nor as negative as the pessimists had feared. Three further negotiating rounds are scheduled during the remainder of 2011,

leading up to the APEC Economic Leaders' Meeting to be hosted by the United States in Hawaii in November 2011. It seems clear that an intense pace of negotiations will be maintained until the end of the year, but equally clear that a final agreement will not be ready for announcement at the APEC Leaders' meeting in Hawaii in November. Announcements along the lines that "broad outlines of an agreement are in place", or that "substantial progress has been made", or that "negotiations are at an advanced stage" would now appear to be the most realistic expectations, as has arguably been the case from early on in the negotiations.

### **Significance of the TPP**

Of the thirty six bilateral relationships or dyads among the TPP participants, only eleven are not already covered by an existing FTA relationship, and the latter are generally of only minor trade importance to at least one and sometimes both of the countries involved. Malaysia, New Zealand, Viet Nam and Brunei are the participants for whom the TPP potentially offers the most significant "prizes", in the form of new FTA relationships with the United States, but these four economies account for only a tiny share of United States trade. In fact the seven economies that joined the United States in the opening TPP negotiations at the beginning of 2010 account for only 4% of United States' trade. Thus the TPP, in establishing a limited number of new bilateral FTA relationships, clearly does not signify a dramatic increase in the overall coverage by FTAs of trade between the current participants, although it is expected of course to also extend the trade coverage of the existing FTAs and to add new more ambitious dimensions to them. Nevertheless, trade potential with the existing TPP members would not seem to explain the level of commitment of the United States to the TPP.

The real significance of the TPP arises from the possibility that additional Asia-Pacific economies may decide to join the TPP in future. As Barfield and Levy 2009 have emphasized, the TPP has a strategic significance for the United States, as it does for the participating countries, as a concrete step toward realization of the trans-Pacific vision of regional economic integration that was embodied first in APEC and more recently in the proposal for a Free Trade Area of the Asia Pacific (FTAAP).

By throwing its weight behind the TPP the United States has also given a clear signal of its determination to maintain and deepen its economic engagement with East Asia. In addition to the obvious political considerations there is clearly also an economic imperative underlying this stance, deriving from the need for a sharp increase in United States exports to re-balance the United States economy and restore sustainability in its external position, with East Asia projected to account for by far the largest share of that increase in exports over the next five years. It is this range of strategic

considerations that presumably accounts for the extent of resources devoted by USTR to a domestic outreach programme to build support for the TPP.

## **Regional Responses**

Recognition of the TPP as both a possible step towards an FTAAP and also as a statement of United States intentions toward trade relations with East Asia serves also to highlight the importance of East Asian responses. This question is clearly linked to the wider question of the future role of the United States in East Asia, which had come into sharper focus in earlier regional debates sparked by the proposals in 2008 and 2009 of Australia's then Prime Minister Rudd for an Asia Pacific Community and by Japan's then Prime Minister Hatoyama for an East Asian Community, with sharply divergent views being expressed for example even within the normally cohesive Singapore policy establishment. Last year's announcement by ASEAN Foreign Ministers that the United States (along with Russia) will be invited to join the East Asian Summit, and the indication that the United States will accept this invitation, were significant developments in this context.

In the economic sphere, deciding on a response to the TPP also raised particularly acute questions for Japan, where concerns were already evident in the business community over how Japan's FTA policy should respond to Korea's FTAs with the United States and (especially) with the European Union, and to the signs that Korea may be about to press ahead with efforts to negotiate its much-discussed FTA with China, following the conclusion of a trade agreement between China and Chinese Taipei. A groundswell of opinion in favour of Japanese participation in the TPP began to develop within the Japanese business sector and large parts of the Japanese policy establishment. In early October 2010 Japan's Prime Minister made a statement indicating that the Japanese government was seriously considering participation in the TPP. This sparked a furious response from agricultural interests in Japan, who mounted a fierce campaign against Japanese participation. In the event Japan's Prime Minister Kan announced a compromise outcome at the APEC Economic Leaders' Meeting in Yokohama, whereby Japan would make its decision on participation in the TPP in mid-2011, and would work during the intervening period on policy measures to assist adjustment in its agricultural sector.

Debate also swirled within APEC over a proposed endorsement by APEC leaders at Yokohama of the FTAAP concept, and the role of the TPP as a potential pathway to realization of the FTAAP. China in particular objected to endorsement of the TPP as the sole pathway to establishment of an FTAAP. A compromise was eventually adopted whereby equal recognition was given to three pathways to the FTAAP: the East Asian Free Trade Area (EAFTA) proposed among the ASEAN Plus Three group,

the Comprehensive Economic Partnership for East Asia (CEPEA) proposed among the ASEAN Plus Six group, and the TPP.

In the opening weeks of 2011, the issue of Japanese participation in the TPP became the most hotly debated topic in Japanese politics. The debate over the TPP quickly came to be seen as representative of the deeper issue of the future weight to be given to greater engagement of Japan with the global economy, as against the priority traditionally given to protecting Japan's increasingly inefficient and dysfunctional agricultural sector. The picture was complicated by the weakness of Prime Minister Kan's DPJ government, and the prospect that its possible imminent collapse would preclude a decision to proceed with TPP participation. In March 2011 the debate was overtaken by the devastating earthquake and tsunami that hit Japan, and the subsequent crisis at the Fukushima nuclear power plant. Faced with the enormous task of recovering from these disasters the Japanese government unsurprisingly announced that the decision on TPP participation would be deferred.

If the TPP is to fulfil its potential as a stepping stone to an eventual FTAAP it is clearly essential that it should attract participation by the major Northeast Asian economies. Japan's decision on participation may therefore be pivotal, as it would be the first of these three economies to come on board, and its decision to join might also add decisive weight to Korea's incentives to participate. Elsewhere in East Asia the Philippines government under newly elected President Benigno Aquino has made statements indicating a serious interest in joining the TPP. This would leave Indonesia and Thailand as the two remaining ASEAN members of APEC yet to indicate a stance toward the TPP.

Looking further ahead the issue of Chinese participation looms as the ultimate challenge for realizing the strategic potential of the TPP. Both China and the United States may have reservations about early involvement in negotiations for an agreement that would include the assumption by them of binding obligations toward each other. On the other hand, if the TPP is viewed primarily as a step along the road to an eventual FTAAP there are risks in deferring Chinese participation. China will understandably wish to have a role in shaping any FTAAP in which it might participate, and may well be inclined to resist proposals that a TPP in whose negotiations it has played no part should be accepted as the basis for design of any FTAAP. It is clear that China is watching TPP developments closely.

Korea is also known to be maintaining a close watch on the TPP. From one perspective the conclusion of the Korea-EU FTA and the prospective ratification of the KORUS FTA means that Korea feels little pressure for early participation in the TPP. Decisions by its North East Asian neighbours to participate in the TPP on the other hand would presumably change the calculus of Korea's interest, and tip the balance toward Korean participation as well.

The difficulties in achieving economic integration in Northeast Asia will also be relevant here. As in the case of EAFTA and CEPEA, simultaneous participation of the three major Northeast Asian economies in the TPP or subsequently in an FTAAP will imply a need for a viable basis to be found for economic integration among themselves.

### **Outlook for the TPP**

In the meantime, successful conclusion of a TPP even among the existing participants faces formidable challenges of both an architectural and political economy nature. In each case there are difficulties relating to both negotiation of an agreement among the current participants and to the provision for, and attraction of, additional participants. Consideration of the interests of potential additional participants has a peculiar importance in the TPP case that derives from the fact that the expected economic benefits of a new trade agreement among the current TPP participants are relatively small, and the larger economic and strategic benefits that are expected to make the exercise worthwhile depend on the future attraction into the TPP of significant new members, especially from East Asia.

Potential new members of the TPP also have choices to make. While the TPP is likely to be formally open to accession by new members at any time, as was also the case with the P4, the ability of acceding members to negotiate revision of the terms and conditions of the agreement is likely to be limited. Their ability to influence the design of the agreement will be greatest if they participate in the current negotiations, which would allow them to exploit the bargaining power that derives from the incremental economic gains that would flow from their inclusion in the TPP.

The outcome of the TPP negotiations themselves, and the role of the TPP in the evolution of East Asia's regional trade architecture, thus remain open questions. In relation to the latter issue much will ultimately depend on the response of those East Asian economies that are not currently participating in the TPP. The deferral of Japan's decision on participation may mean that other economies are inclined to adopt a 'wait and see' attitude, which in turn adds to the importance of the outcome of the negotiations. In this regard questions remain over the ability of the Obama Administration to sustain the initial political impetus that it imparted to TPP participation, given a hostile Congress and a generally toxic domestic political climate. The challenge for the Administration is all the greater because it lacks Trade Promotion Authority (TPA) and is unlikely to secure it in the current climate. The likelihood that negotiations will not reach a final conclusion by November 2011 inevitably raises questions of how much can be achieved in the US election year of 2012.

Developments in the WTO negotiations may also play a part. After an initial flurry of renewed enthusiasm early in 2011 the mood surrounding the Doha negotiations now appears to have turned seriously pessimistic, with the real possibility of a final collapse of the negotiations now being openly discussed in some informed quarters. Conventional wisdom might suggest that the prospect of a collapse in Geneva would tend to heighten the importance attached to the TPP negotiations by the participating economies. On the other hand there might also be questions as to how far the political factors being cited for the possible collapse of the Doha negotiations, in particular the lack of perceived political advantages from concluding a deal to set against the perceived political costs, might also tend to undermine the TPP negotiations as well. In particular, the reaction within the United States' political system will be crucial.

### **Services in the TPP**

The importance of the TPP derives from its potential to develop as a major region-wide trans-Pacific trade agreement, marking a decisive step towards the objective of free trade and investment across the Asia-Pacific region. Its importance is further underlined when its development is set against the growing pessimism surrounding the stalled WTO Doha negotiations and the continuing uncertainty as to when the EAFTA and CEPEA initiatives in East Asia might progress to the negotiating stage. In these circumstances the promotion of trans-Pacific free trade through the TPP may appeal as the most accessible current avenue for the economies of the Asia-Pacific to advance a significant trade liberalization agenda in the immediate future. The services outcomes in TPP should also be aiming to set relevant benchmarks for any "post Doha" services negotiating efforts in the WTO.

Services trade has not had a high profile to date in public discussions surrounding the TPP negotiations. Yet services could potentially be one of the most significant components of an eventual TPP agreement, for at least two reasons. In the first place, the countries participating in the TPP represent a very significant market for services, and the services sector represents a very substantial part of their combined economies. Second, if the rhetoric of the TPP as a "high quality, twenty-first century agreement" is to be taken seriously, it should surely imply that the TPP should be seen as an opportunity to move beyond the established approaches to services trade and investment liberalisation exhibited in the WTO and existing FTAs, which have for the most part disappointed in the extent to which they have driven forward meaningful services trade liberalisation in ways that resonate with the needs of business. There is potential also for the services provisions of the

TPP to develop synergies with the services components of other regional initiatives such as the ASEAN Economic Community.

Relatively sophisticated examples of conventional GATS+ approaches to services trade liberalization in FTAs can be found in the various FTAs already concluded by TPP participants, for example the “NAFTA-style” services provisions of the US FTAs with Australia, Chile, Perú and Singapore, and the original “P4” agreement that provided the genesis of the TPP initiative. For example, these agreements feature a “negative list” approach to scheduling of commitments and include MFN provisions and “ratchet” clauses. The original “P4” agreement, however, did not cover financial services, nor did it include an investment chapter, which was to be negotiated within two years after entry into force

Arguably the TPP will need to break new ground if it is to advance services trade and investment liberalization in commercially meaningful ways. Examples of areas that are inadequately addressed in existing agreements, and where the opportunity therefore exists for the TPP to make a meaningful difference to the way that regional services business is conducted, include regulatory coherence, competition policy, government procurement, people movement, mutual recognition of qualifications and interoperability of standards. Other issues that regional businesses have claimed are insufficiently addressed in the services provisions of existing agreements include services aspects of supply chain connectivity, facilitation of SME engagement in services innovation and export, services sector subsidies, and services operations of state-owned enterprises.

The condensed time frame for the TPP negotiations reinforces the challenge of developing services trade provisions that could genuinely be described as “twenty-first” century. It will be disappointing if the opportunity is missed.