

Trans-Pacific Partnership Agreement: Issues and Challenges

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Abstract:

In December 2012, officials will be gathering in Auckland from across the eleven participating countries of the Trans-Pacific Partnership (TPP)—Australia, Brunei, Canada, Chile, New Zealand, Malaysia, Mexico, Peru, Singapore, United States and Vietnam. The TPP is trying to be a new type of broad, deep preferential trade agreement (PTA). The Auckland meeting represents a good time to take stock of the issues and challenges remaining in market access in goods, rules of origin, services, competition policy and state-owned enterprises, government procurement, intellectual property rights, labor, environment, dispute settlement.

Introduction:

The Trans-Pacific Partnership (TPP) is a different kind of trade agreement. Officials regularly tout the “high quality, 21st century” aspirations of

the members.¹ Member states currently include eleven partners drawn from three continents at diverse levels of economic development, including Australia, Brunei, Canada, Chile, New Zealand, Malaysia, Mexico, Peru, Singapore, United States and Vietnam. The agreement covers not only trade in goods, services and investment but also includes extensive “behind the border” issues including the creation of similar or compatible regulations and standards. It incorporates issues like labor, the environment, economic development, and fostering small and medium enterprises. And it makes the whole package of nearly 30 different chapters legally binding with a robust enforcement mechanism.

The agreement has grown rapidly from four members (Brunei, Chile, New Zealand and Singapore) to eight (adding Australia, Peru, United States and Vietnam) in 2009, to nine in 2010 with the addition of Malaysia, and to eleven with the addition of Canada and Mexico in late 2012. The agreement continues to attract interest from new partners. Just in November 2012, two new potential members, Thailand and Japan, pushed the ideas of their membership forward. The TPP is open to additional members, particularly those located in Asia Pacific Economic Cooperation (APEC).²

The TPP does not exist in a vacuum. The current eleven members are linked by 46 separate bilateral and regional agreements.³ These preferential

¹ The extent to which this is so is open to question. See Lim, Elms and Low (eds.), *Trans-Pacific Partnership: The Quest for a 21st Century Trade Agreement* (Cambridge University Press, August 2012).

² Accession requires bilateral meetings with existing members, followed by a meeting with the collective group. Decision to admit a new member must be reached by consensus of the existing members.

³ Actually, the number is even higher if, for example, the ASEAN commitments with outside partners, like ASEAN+China or ASEAN+India were also counted as binding ASEAN members Singapore or Malaysia together in addition to their general ASEAN commitments to one another.

trade agreements (PTAs) complicate efforts to reach a new commitment that will extend additional benefits to the partners while simultaneously avoiding undermining existing promises.

This makes the TPP an extremely complex negotiating environment. The topics are difficult, with commitments that are both broad in scope and deep. In many ways, the TPP could be viewed as more difficult to negotiate than the World Trade Organization, as the agenda is much more complicated, even if the number of participants is smaller. The TPP is trying to break new ground in some areas and push countries to undertake additional liberalization in others.

Member states have pledged to have similar commitments at the end of the phase-in periods, regardless of levels economic development. And the number of actors at the table has continued to shift as new members are added. Because the agreement is meant to expand further in the future, the final document must also attract and appeal to potential new members going forward. This has given rise to a host of issues and challenges that have complicated the talks after nearly three years.

The Status of Negotiations

Negotiations in the TPP started in earnest in March 2010. At the start of the 15th round in early December 2012, membership was set to expand from nine to eleven with the addition of Canada and Mexico. This represents an excellent time to pause and take stock of the status of talks.

Two important caveats are in order, however. First, the negotiations in the TPP can be viewed as a “single undertaking.” This means that for many members, the negotiations must be viewed as an entire package. None of the specific chapters can be pulled out and seen as “closed” until the whole

agreement concludes as there may be tradeoffs to be made between and among chapters at the last moment. Second, the addition of new members may alter the outlines of the agreement already on the table. Although it is highly unlikely that new members will effectively “tear up and start over” some key elements of the existing texts, it is certainly possible that new members will influence the shape of the whole package going forward. Adjustments of the package are unlikely to be confined only to new areas or new issues.

Subject to these key caveats, this section highlights some of the challenging areas remaining in the negotiations, including the following: market access in goods, rules of origin, services, competition policy and state-owned enterprises, government procurement, intellectual property rights, labor, environment, dispute settlement.

Market Access for Goods: There are two tough issues related to market access for goods that are still outstanding. One is a broad, structural issue and the other is a set of narrower, specific topics of concern to member states. As noted above, the TPP members are tied together by a dense web of existing preferential trade agreements (PTAs). Every PTA includes market liberalization for goods, so TPP members already have extensive experience negotiating in this arena. They may not always agree with one another on the extent of necessary market opening in the TPP, but they are quite aware of their own sensitive issues and often have a clear understanding of the tough issues for their partners.

Negotiations in goods are being handled in two parallel tracks. For all countries with which the United States does not already have an existing FTA (Brunei, Malaysia, New Zealand, and Vietnam), the U.S. has been making bilateral offers. For countries with existing FTAs, these offers stand as the American TPP

goods schedule.⁴ Peru also operates on a similar path to the United States. The other negotiating track involves the remaining seven countries (prior to the addition of Canada and Mexico to the negotiating table in December 2012) making plurilateral offers on market access that will apply to all seven parties. Both negotiating tracks include dropping tariffs on 90% of lines to zero at the time of TPP implementation. By the time the agreement comes fully online—if all goes well—both paths will result in the same outcomes of at or near 100% coverage of tariff lines at or near zero tariffs. In other words, the TPP is poised to have extremely comprehensive coverage in market access in goods.

However, the extent to which this goal will be realized is not entirely clear, as there are a few sensitive products noted below. Thus far, negotiations over these sectors have been limited and most observers believe that resolution for most will have to wait until the final end game for the whole agreement.

Textiles and Footwear: One of the most difficult issues on market access that is being tackled in the bilateral track has been textiles and footwear. Vietnam and Malaysia do not currently have preferential access to the American market, as neither has an existing PTA. Both have competitive garment industries. The United States has a mind bogglingly complex system in place to protect textiles and footwear that involves both high tariffs as well as special rules of origin. So far, the negotiators have not gotten very far in the TPP talks on how to increase market access into the American market for textiles or

⁴ Any agreement that has been fully implemented (i.e., the North American Free Trade Agreement or NAFTA commitments) is eligible for further discussions in the TPP by the United States. The U.S. has decided that the market access schedules in agreements that have not been fully implemented (i.e., the US-Australia FTA) are not open for discussion in the TPP.

footwear by either significantly lowering tariffs or changing a difficult rule of origin criteria (the so-called yarn-forward rule, discussed further below).

Textiles and footwear are important obstacles in the TPP going far beyond the specifics of whether or not t-shirts are more easily exported in the future. At the moment, they are holding up some other elements of the negotiations as Vietnam (in particular) is waiting for concessions in textiles and footwear before it is willing to move elsewhere on objectives more important to the United States. Further, as Mexico joins the talks, the issues of textiles and footwear may become more difficult and not easier, since Mexico is also a competitive producer of garments with special access already guaranteed into the American market.

Sugar. Another particularly vexing market access issue has been sugar. Sugar is highly protected in the United States and is also a sensitive product for Chile and Mexico. Sugar is protected in the United States by using tariff rate quotas (TRQs) with limited amounts of raw cane sugar, refined sugar, specialty sugar, and sugar-containing products allowed into the market under both WTO rules and most FTAs. However, in the U.S.-Australia FTA, sugar was explicitly carved out completely.⁵ Maintaining this carve out on sugar sets up a dangerous precedent that could allow other TPP member countries to insist on carving out their own highly sensitive products, sectors and industries.

Dairy. Another sensitive sector for market access is dairy. Dairy is less than free into Canada and the United States, in particular. Canadian tariffs on dairy are as high as 315 percent and concerns over its supply management

⁵ This was part of a larger “bargain” of sorts that allowed Australia to opt out of investor-state dispute settlement. Both aspects of this bilateral FTA are now causing problems in the TPP as noted further below.

system delayed Canadian entry into the TPP for more than two years.⁶ For New Zealand, greater access to the American dairy market was a key driver of Kiwi interest in the entire agreement. However, by December 2012, talks had hardly begun on market access in dairy. The entry of Canada into the negotiations is guaranteed to slow talks in this sector further.

Rules of Origin. Every free trade agreement gives benefits to members that are not available to non-members. Therefore, each FTA must specify the rules that ensure that these benefits go only to member firms, called rules of origin (ROOs). The extent of market opening depends on the interaction between tariff reductions and rules of origin. For example, low tariffs will not benefit member firms if the ROOs are so complex or so difficult to comply with that no firms manage to qualify for preferential tariff rates under the FTA.

The TPP could have opted for clean, simple ROOs. Thus far, they have not. Instead, members have been crafting product-specific ROOs. It will require, for example, a chemical manufacturer to go through the inventory and determine (potentially) a different ROO calculation for each and every item in the inventory, even if the entire inventory is being shipped only to other TPP member countries.⁷ The ROOs have not been fully written yet, so it could still be that some are easier for firms to use than others.

⁶ The management system covers both dairy and poultry, although the focus of the TPP members, especially Australia, New Zealand and the United States, was mostly on dairy. Bilateral discussions with Canadian officials in 2010 ended without an offer of entry into the TPP because it was not clear that Canada was prepared to discuss dismantling or significantly changing the dairy system at that time.

⁷ Of course, this may not be true. It will depend on whether or not each item of inventory falls into a different product category using HS codes at the 6 digit level. For many companies, multiple products are likely to be lumped together at this level of specificity in the tariff codes.

Given the high-quality aspirations of the agreement and the stated desire to facilitate supply chains in the region, members might reasonably have been expected to make it easy for firms to cumulate inputs. This would have allowed companies to add together the components sourced from TPP members and “count” this as TPP content for the purposes of ROO calculation at a relatively low level of the overall content. These discussions have not yet concluded and have proven extremely contentious. After two years of bargaining, the TPP members have not yet decided in favor of low cumulation ROO rules.

One of the least market-opening rules of origin, however, is the United States’ insistence on using something called “yarn-forward” for textile and apparel products. This rule requires that all products destined for American markets be made all the way to the finished product from U.S.-produced yarn.⁸ Although the negotiations are not done, any move to continue using yarn-forward ROOs in the TPP undermines the high-quality aspirations of the agreement and remain controversial among members.

Finally, TPP members have yet to address what to do about tariff rate quotas (TRQs) in the TPP. A high-quality, ambitious agreement ought not have them at all. Yet a decision to abandon the practice in the TPP will also undermine their use in the various bilateral and regional agreements where they currently exist. As an example, the U.S.-Peru FTA grants Peru a TRQ on raw sugar. If the TPP does not have TRQs, Peru could presumably export more sugar to the United States than the bilateral agreement specifies.

⁸ With only some exceptions, largely for categories like silk where the United States does not produce any silk yarn.

Services. The services negotiations in the TPP are being conducted on the basis of a negative list. This is a different method of liberalizing services from that used by the WTO (the so-called “positive list” approach). Under a negative list, stated simply, members note the sectors where they do *not* intend to grant market opening. All else is open for competition. The negative list has been extensively used by the United States in FTA negotiations and, by extension, in all its trade partners. But it has never been used by Malaysia or Vietnam before and, as a result, it has taken some time to get close to an agreement. One area of particular sensitivity for negotiators has been financial services.

Another difficult area of discussion has been the movement of service providers. The TPP will not open markets to the free movement of labor. However, there are provisions to allow skilled service professionals to move more easily on a temporary basis. These rules are still under discussion, including the mutual recognition agreements (MRAs) necessary to determine the qualifications that are necessary for such persons to hold before being considered for special entry into TPP markets.

Competition Policy and SOEs. The TPP will have rules crafted to ensure free and fair competition applies to TPP member markets. These rules, which include such elements as anti-trust laws and measures, are designed to enhance the competitiveness of markets. One controversial component of the TPP that has never been included in an FTA is a section on state-owned enterprises (SOEs). The SOE provisions are supposed to ensure that these kinds of firms do not receive unfair competitive advantages in the form of government assistance, cheaper access to credit and so forth that are not available to other firms in the

marketplace. For now, this aspect of the competition chapter remains in square brackets, indicating no agreement among members.

Government Procurement: Most of the TPP members are not members of the WTO's Government Procurement Agreement.⁹ However, the TPP agreement will bind members to open their procurement markets to one another. At the moment, it commits members only to the federal level, subject to fairly high threshold levels. Since for many countries, significant procurement takes place at the sub-federal level, this issue is still outstanding.¹⁰

Intellectual Property Rights: The disputes over IP issues could (and probably will eventually) fill an entire book. The IP draft chapter is the only text of the TPP agreement that has been consistently leaked to outside observers. The repeated leaks have allowed others to weigh in on the debates over different provisions.

Within the chapter, there are various elements causing the most controversy. For example, on copyright, an initial draft provision called for life of the author plus 100 years protection.¹¹ This is a significant extension of existing provisions, even from bilateral FTAs, and has provoked concern in many quarters. There have been equally fierce disagreements on the extent to which members are required to protect trade secrets and rules to govern enforcement of IP overall.

⁹ Only Canada, Singapore and the United States are full members of the WTO's GPA. Australia, Chile, Malaysia and New Zealand are observers, but New Zealand is currently negotiating full accession.

¹⁰ Part of the problem is that USTR has not received permission from very many of the U.S. states to open their markets to binding commitments in the TPP. The U.S. constitution does not allow the federal government to commit the states without their consent.

¹¹ Several IP experts have called this "the Disney provision," since the Walt Disney protections are due to expire in 2019 under existing levels of protection.

Other controversial areas include a host of issues attached to the pharmaceutical industry and patent protection. Officials are wrestling with how to write rules to cover drug pricing and reimbursement, particularly for countries with national drug formularies (like New Zealand). Also controversial is how to adjust patent protection lengths, especially for different classes of pharmaceutical products like biologics. Drug companies have argued that they need longer time periods of protection to recoup high investment costs associated with these classes of products.

Another issue sits at the intersection between IP and e-commerce and concerns how companies should be required to handle data flows across borders. Some TPP members have expressed unease about rules that require the placement of data servers in their geographical territory while others have expressed exactly the opposite concern.

Labor: The TPP will have a chapter on labor because the final agreement will not survive passage in the U.S. Congress without one. The easiest path would be to require TPP members to enforce the eight International Labor Organization conventions on labor. However, this is a tricky issue for the United States, because the U.S. has only signed two of the eight conventions.¹²

Environment: The TPP will also have a chapter on the environment. It covers a host of environmental issues, including fisheries subsidies,¹³ conservation of wildlife, and rules on illegal logging. The most controversial issue is how much of the chapter should be made legally binding. In particular, if

¹² For further details, see Kimberly Ann Elliott, "Labor Standards and the TPP," Lim, Elms, Low (eds.), *Trans-Pacific Partnership: A Quest for a 21st Century Trade Agreement*, Cambridge University Press, August 2012, 200-210.

¹³ Which may end up being placed a different chapter at the conclusion of the talks.

the chapter requires members to uphold their commitments to multilateral environmental agreements (MEAs) and this commitment becomes legally binding, members are being asked to be held legally accountable to treaties under the TPP which they may never have intended to commit to in this fashion.

Dispute Settlement: The TPP is to have a robust dispute settlement chapter. Member states will not be able to simply rely on the WTO to adjudicate disputes, as many of the provisions in the TPP go well beyond any existing WTO commitments.

As noted above in the sections on labor and environment, one issue for member governments is how much of the TPP agreement to make legally binding. These two chapters are the most controversial, but another area under discussion could be broadly put under the heading of regulations. For example, many businesses have been lobbying for stronger sanitary and phytosanitary (SPS) rules in the TPP. After all, many barriers to trade are now found in regulatory obstacles that prevent or make trade more difficult. These are often found in arbitrary rules around food and agriculture. Governments have the right to regulate for health and safety as well as environmental protection, but governments have been known to use SPS rules to protect local farmers from foreign competition. Some TPP members have therefore been pushing for new, legally binding, SPS rules that go beyond those at the WTO that will facilitate trade in food products.

Another highly controversial area has become investor-state dispute settlement (ISDS). As noted earlier, this was entirely carved out of the bilateral Australia-U.S. FTA. Australia has announced that it will not be bound to ISDS in the TPP either. But this provision is viewed as highly important for the

protection of investor interests in many TPP countries. In addition, allowing one member to opt out of a provision like ISDS sets a precedent that would allow other TPP members to opt out of different elements of the final agreement that they find disagreeable.

Issues Ahead

It is not yet clear how the market access schedules will be handled at the end of the negotiations. At the moment, there are multiple schedules. Most likely, they will be bundled together with one broad schedule that applies to all TPP members for most goods. But there will be some subset of goods handled differently for some countries vis-à-vis trade with the United States (and likely with Peru). It is possible that this will remain an artifact of history once the TPP is fully implemented if all schedules come into agreement at that point.

However, this is not automatically guaranteed. For the moment, officials have decided to continue to negotiate and narrow their differences and deal with the merger of the two tracks at the end.

The addition of new members adds a difficult dimension to the negotiations. Canada and Mexico received the first look at the draft texts of the agreement only in October 2012 after 14 rounds and several intercessional meetings had already taken place. The December 2012 meeting will be their first opportunity to fully participate in the talks and no one quite knows what to expect.

Other countries, including Japan, Thailand, Costa Rica and Columbia, have expressed an interest in joining the TPP. So far, only Japan has taken the first step of meeting bilaterally with current members. It is not clear how quickly any

of these potential members might be able to join.¹⁴ On the horizon are other APEC members including Korea and China. If the TPP is to become the FTAAP, it will need to expand further in the future.

Finally, members have been quite clear that they do not intend to allow the TPP negotiations to “become another Doha,” drifting for a decade without conclusion. Officials have been working at a furious pace to wrap up talks as quickly as possible. The earliest likely date for conclusion (if no additional country joins in this cycle) is probably end 2013. Most major TPP announcements have taken place on the sidelines of APEC and the conclusion of talks could be given in Indonesia in November.

¹⁴ One additional complication is a U.S. rule that requires USTR to notify Congress of their intention to start negotiations with new countries and wait 90 days before proceeding. It is possible that Thai membership could be handled under existing authorization from Congress for a now-dormant bilateral FTA, avoiding the 90 day wait.