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ECONOMICS OF THE TPP AND RCEP NEGOTIATIONS

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Abstract

Asia-Pacific trade diplomacy intensified in 2012 with the launch of new China-Japan-Korea and Regional Comprehensive Economic Partnership (RCEP) negotiations, and with several countries added to the Trans-Pacific Partnership (TPP) negotiations. This paper estimates global income gains from these initiatives and compares outcomes on the two tracks. Although its standards are likely to be less demanding, RCEP would generate somewhat higher total benefits because its members have higher barriers and the largest—China, India, Japan and Korea—do not yet have FTAs covering their trade. ASEAN countries would gain more from joining the TPP, since they do have FTAs with other Asian economies, but not with the United States and some other TPP partners. Eventually, most countries, except for China and the United States, could join both tracks. A broad Free Trade Area of the Asia Pacific would yield the largest gains, especially for China and the United States.

Keywords: Trans-Pacific Partnership, Asian economic integration, U.S. trade policy, free trade areas, regional economic integration.

JEL codes: F12, F13, F14, F15, F17.

ECONOMICS OF THE TPP AND RCEP NEGOTIATIONS

Peter A. Petri

The year 2012 may stand out as a turning point in the history of Asia-Pacific trade diplomacy: the East Asia Summit in Phnom Penh launched a major new negotiation toward a Regional Comprehensive Economic Partnership (RCEP), and new countries joined the negotiations on the proposed Trans-Pacific Partnership agreement (TPP). These Asian and trans-Pacific tracks of negotiations differ in important ways, but they are likely to accelerate economic integration in the region and perhaps worldwide. An over-simplified forecast is that the trans-Pacific track will advance more rapidly with higher standards, while the Asian track will move more slowly with relaxed standards. This could mean that the TPP will initially attract fewer and more advanced members than the Asian track. The results describe here show that the region's long-term goal should still be a wider Free Trade Area of the Asia Pacific (FTAAP), but both tracks could make contributions to that end.

Both negotiations face complex challenges and will be difficult to conclude. The TPP, with 14 rounds of negotiations now behind it, is in its final stages, while RCEP is just beginning its journey. It is difficult to predict how fast or how extensively they will liberalize trade. This paper—based on an ongoing study of the Asian and TPP negotiating tracks by Michael Plummer, Fan Zhai and me¹—reports several speculative findings on what the outcomes might be, including new simulations of the TPP negotiations and the Regional Comprehensive Economic Partnership (RCEP) negotiations launched in November 2012 in Phnom Penh.

Assuming that templates similar to those of past agreements will be adopted, we can show that both tracks will benefit the economies that participate in them, with the scale of gains determined

¹ Peter A. Petri, Michael G. Plummer and Fan Zhai (2012), *The Trans-Pacific Partnership and Asia Pacific Integration: A Quantitative Assessment*. See also the website: asiapacifictrade.org.

by trade patterns and previous trade agreements. We also find that RCEP would generate somewhat larger benefits than the TPP, because it should cover the trade relations of Asia's giant economies (China, Japan, Korea and India); their links are not subject to FTAs so far. For many Southeast Asian economies, however, the TPP will be especially important—fewer ASEAN economies now have FTAs with the United States than with China and other Northeast Asian partners. In practice, most economies will probably have the option of participating in both tracks and it's difficult to imagine that they will avoid doing so in the long run.

Eventually, China and the United States could be among the very few countries left *without* preferential access to both of their huge markets. This will generate incentives for them to promote consolidation of the two tracks. We cannot be sure of this optimistic outcome, of course, but we can demonstrate the highly positive-sum context of regional integration in the Asia-Pacific. This positive context also drives our policy conclusions, which argue for rapid progress on both tracks as well as long-term efforts to reduce policy differences between China and the United States.

I. The significance of Asia Pacific integration

Asia Pacific trade is the logical setting for major new trade agreements due to its scale and dynamism. Of the world's \$14.3 trillion in trade in 2010, all but \$4.7 trillion involved APEC countries—a useful, though somewhat arbitrary definition of the Asia Pacific region—as either an exporter or importer (Table 1) or both. About half of the region's trade consisted of intra-regional trade, which in turn included \$1 trillion in trade within the Americas, \$2.3 trillion within Asia and Oceania, and \$1.6 trillion across the Pacific. Since a significant portion of the trade within the region involved components of manufactured products, trans-Pacific trade represents an even larger share of the region's "value added" trade.

Asia-Pacific trade is also exceptionally dynamic. The region's diverse resource endowments and development levels enable it to exploit major specialization advantages: the exchange of manufactured goods and primary materials for high-technology products and services. The region's international production networks also represent a major innovation in manufacturing.

The dynamism of Asia-Pacific trade could further increase as the region gains in share of world GDP (Table 2). Meanwhile, the majority of regional output will shift from the Americas to Asian economies.

Table 1. Trade flows in the Asia Pacific, 2010 (\$bill.)

	Americas	Asia	Oceania	Russia	ROW	World
Americas	999	397	28	8	635	2,067
Asia	740	2,291	109	51	1,340	4,532
Oceania	14	154	14	1	55	238
Russia	14	53	0	0	332	400
ROW	894	1,198	62	177	4,720	7,050
World	2,661	4,094	214	237	7,082	14,287

Source: APEC Bilateral Database, accessed 25 February 2012.

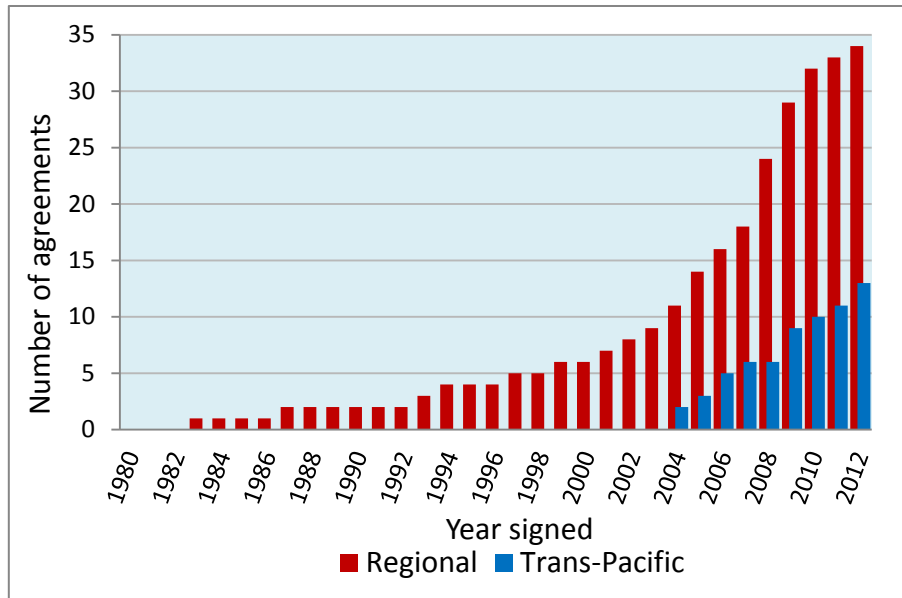
Table 2. Projected growth in the Asia Pacific, 2010-25

	GDP USD2007bill.		2010-25 Growth	Share of World GDP	
	2010	2025		2010	2025
Americas	16,784	24,918	2.7	28.8	24.4
Asia	11,856	27,999	5.9	20.4	27.5
Oceania	1,056	1,632	2.9	1.8	1.6
Russia	1,323	2,790	5.1	2.3	2.7
ROW	27,182	44,627	3.4	46.7	43.8
World	58,201	101,967	3.8	100.0	100.0

Source: Petri et al. (2012).

The framework for developing new rules for trade has been gradually responding to these trends. There were only four major trade agreements among APEC economies before 2000—the ASEAN Free Trade Area, the Canada-U.S. Free Trade area, the North American Free Trade Area, and the Australia-New Zealand Closer Economic Relations accord; today there are 47 with others in the works (Figure 1). Indeed, as Figure 1 shows, the most recent wave of Asia Pacific trade agreements has focused precisely on flows connecting the Asia-Pacific’s eastern and western sub-regions.

Figure 1. Trends in Asia Pacific trade agreements



Note: among APEC members.

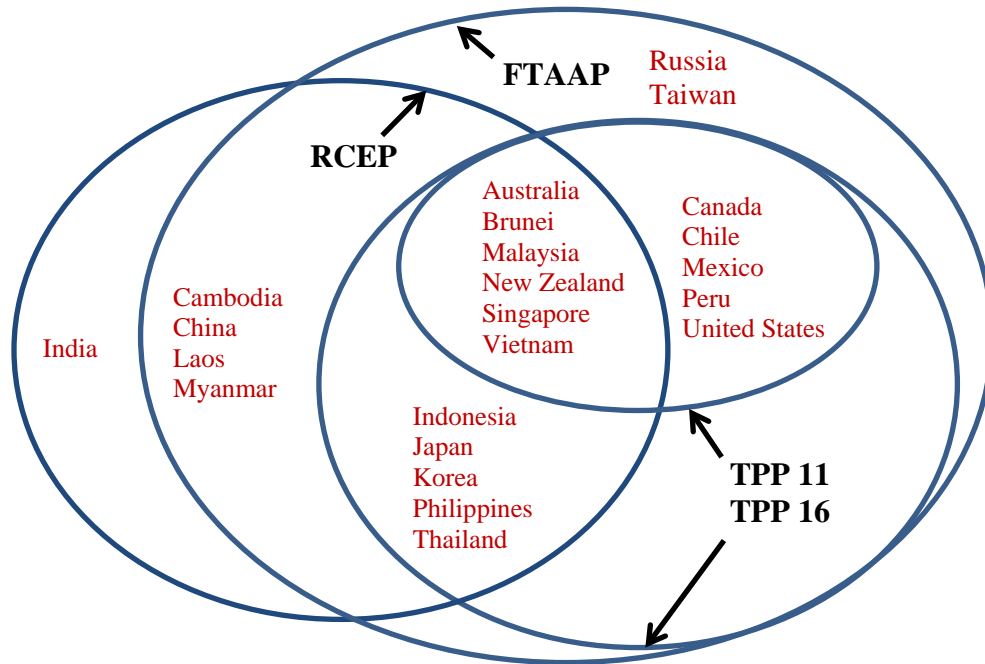
Source: ESCAP database. Simdata/t-agree

The surge of smaller trade agreements is also creating new sources of uncertainty for regional trade. A comprehensive regional or global system could offer significant advantages relative to both the Asian and Trans-Pacific tracks, but it would be extremely difficult to negotiate. Thus, the practical challenge facing policy today is to shape the Asian and Trans-Pacific tracks in ways that realize the gains achievable in the short run without undermining the prospects for a comprehensive regional system in the future.

II. Structure of Asian and Trans-Pacific integration tracks

This study examines four trade agreements that are the most concrete initiatives so far toward regional integration in the Asia-Pacific. Two—the 11-member TPP and 16-member RCEP initiatives—are or will soon be in negotiation. In addition, we expect a larger 16-member TPP agreement to emerge eventually, since four of the five countries that would be added to the 11-member TPP have already indicated their interest in joining. The fourth, the 21-member FTAAP is an important beacon; it has been repeatedly cited by APEC leaders as their long-term goal.

Figure 2. Schematic view of Asian and Trans-Pacific tracks



Source: author.

The Asian track

Asia’s trading system is emerging from a framework established by the ten members of the Association of Southeast Asian Nations (ASEAN). Their core integration project—the ASEAN Economic Community (AEC)—is the most ambitious such effort so far among emerging economies (Petri, Plummer and Zhai, 2010). ASEAN’s economic role is also reinforced by political considerations, including its strategic location astride East Asia’s critical trade routes, its neutral position in the traditional tensions of Northeast Asian countries, and its intermediary role between China and the United States and China and India. China was quick to launch free trade negotiations with ASEAN in 2002, which became a full FTA in 2010, and these initiatives led to similar agreements between ASEAN and Japan, Korea, India, Australia and New Zealand.

Plans for a genuine Asia-wide agreement have a more recent history and challenging mission. In 2004, the economic ministers of ASEAN, China, Japan and Korea (the ASEAN+3) commissioned a feasibility study on an East Asia FTA. Then in 2005 ASEAN established an East Asia Summit (EAS), with a membership expanded to include Australia, New Zealand and

India (the ASEAN+6). At the 2007 EAS Japan then proposed a free trade agreement based on the larger group, to be called the Comprehensive Economic Partnership of East Asia. These two frameworks remained in discussion for the next five years, with progress slowed by disagreements between China and Japan about which grouping should take precedence. A breakthrough began to emerge in 2009, initially with agreement that both proposals could proceed in parallel.

China, Japan and Korea (CJK), whose bilateral trade is central to any Asia-wide agreement, concluded a trilateral investment treaty and a study of a trilateral FTA in 2011. Despite the political tensions that subsequently developed among the three, and perhaps stimulated by progress under the TPP, formal FTA negotiations were then launched at ASEAN's Phnom Penh summit. In addition, ASEAN drafted—with support from both China and Japan—its own model for a regional agreement, the Regional Comprehensive Economic Partnership framework. Also in Phnom Penh, the ASEAN+6 countries committed to launching negotiations on RCEP and to reaching an agreement by 2015. To be sure, progress will not be easy; political tensions remain and many difficult economic issues will have to be settled. While the project of Asian economic integration is now officially underway, the 2015 deadline is almost certainly too optimistic (Zhiming 2011).

The Trans-Pacific track

The concept of Asia-Pacific economic integration dates back to the 1960s to proposals developed in the Pacific Trade and Development forum (PAFTAD) and eventually the quasi-governmental Pacific Economic Cooperation Council (PECC). The official Asia Pacific Economic Cooperation (APEC) forum, established in 1989, was partly based on this vision and adopted the goal of “free trade and investment in the region” in its 1994 Bogor Declaration. However, APEC eventually narrowed its focus to trade facilitation and other voluntary mechanisms, since its efforts to pursue trade agreements failed with the “Early Voluntary Sectoral Liberalization” initiative of 1998. APEC has, however, encouraged “pathfinder” initiatives among groups of economies, and one such effort, the 2005 Trans-Pacific Strategic Economic Partnership (known as the P4) by Brunei, Chile, New Zealand and Singapore, has emerged as the seed of the current TPP initiative.

The TPP negotiations were energized by the decision of the United States in 2008 to propose joining the P4. Australia, Peru and Vietnam also announced their intention to join. The initiative gathered steam in late 2009 when President Obama made the TPP a centerpiece of his new trade policy. Malaysia joined the negotiations in October 2010, as did Canada and Mexico in 2012. But the TPP has missed some of its first (and probably overly ambitious) deadlines and has met some disappointments—Japan’s participation, which appeared likely following Prime Minister Kan’s announcement in late 2011, has since bogged down in domestic politics, and Thailand’s official interest is also facing internal debates. It may take more time and perhaps additional “TPP victories” for these countries to push ahead for membership. A mechanism that permits future waves of accession is therefore an especially important element of the TPP.

With the 2012 US presidential elections over, many observers now expect that an agreement among the 11 countries now negotiating will be concluded in 2013. The TPP is reasonably likely to get the required support in the US legislative process, including perhaps “fast track” authority that helps the president negotiate a final deal. Congress has approved the Colombia, Korea and Panama FTAs with solid bipartisan majorities and will have reason to support the TPP also as part of the Obama administration’s strategic engagement with Asia.

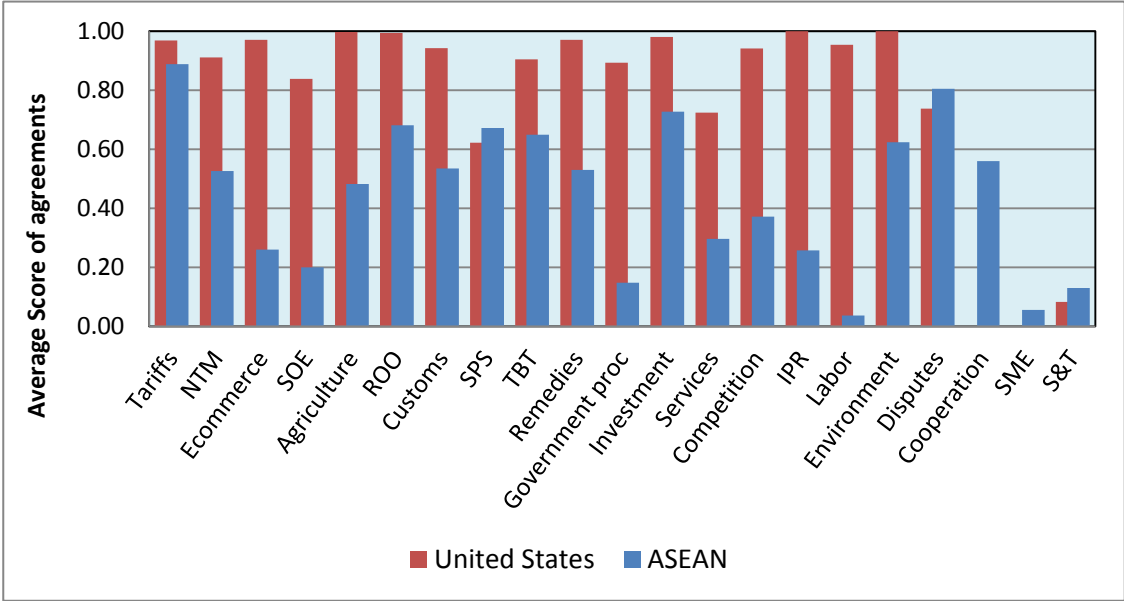
Differences in templates

The templates likely to be used by the Asian and Trans-Pacific tracks can be projected, within obvious margins of error, by examining recent trade agreements concluded by ASEAN and the United States. An analysis of these agreements shows, for example, that improvements in market access in goods, including especially reductions of tariffs, appear prominently in both tracks of agreements. Asian and US templates have cut tariffs, on average, by 90% and 96%, respectively, in the ten years following implementation. However, Asian tariff cuts have been somewhat slower to take effect and, applied to higher initial tariffs, have left larger barriers behind. Even U.S. agreements have excluded some products like sugar, but Asian agreements have generally permitted wider exceptions, especially for agricultural commodities.

The differences are still greater for non-tariff measures. We have developed a database of trade agreements that includes scores that attempt to assess the rigor of provisions in 21 issue areas

commonly contained in trade agreements (Figure 3).² Agreements concluded by the United States have had higher scores than Asian agreements across the board, perhaps reflecting the more advanced legal environment in the United States and its FTA partners. The differences are especially large on issues such as government procurement, intellectual property rights, investment, and competition—areas that are also proving contentious in the TPP negotiations. ASEAN agreements, by contrast, have more limited provisions on average, but have stronger provisions on cooperation and collaborative dispute resolution.

Figure 3. Average scores of recent trade agreement provisions on major issues



Source: Petri, Plummer and Zhai (2011).

The differences between agreements are not accidental; they reflect contrasts between the economic interests of Asian economies and advanced countries like the United States. Asian agreements seek to preserve “policy space” and encourage trade in manufactures, consistent with the comparative advantages of countries in early and middle stages of development. Agreements concluded by the United States, in turn, focus on expanding market access for sectors that represent their areas of comparative advantage, including services, investment and intellectual property. International economics argues that the growth of trade, including in sectors of interest

² Peter A. Petri, Michael G. Plummer and Fan Zhai, “The Economics of the ASEAN Economic Community,” Unpublished manuscript, 2011.

to emerging economies, requires export opportunities for all participants—market access for the leading sectors of advanced countries enables them to earn export revenues and generates political support for liberalization. The absence of such opportunities in the Doha negotiations, as Hufbauer, Schott and Foong (2010) have argued, probably accounts for the lack of enthusiasm in the developed world for the round. Deals on new fields of economic interaction—so-called 21st century issues—will be essential for lining up support in developed countries for policies that broadly facilitate trade.

Interaction of the tracks

The Asian and Trans-Pacific tracks are interdependent. Each influences the other by demonstrating progress, attracting members, or adopting “better” provisions. The tracks also compete for legitimacy in the international policy community. Competition among regional negotiations is often seen as constructive (Baldwin 2006), but theories about long-term effects are ambiguous: regional agreements could lead to greater general liberalization, or could end up creating large protectionist blocs. In the event, the proliferation of regional and bilateral negotiations today is generating overlapping agreements and does not appear to foreshadow bifurcated blocs. The current path may cause inefficiencies due to confusing rules, but does not appear to be moving toward an antagonistically partitioned trading system, such as the cold-war era trade blocs. In the Asia-Pacific, many economies are considering both regional tracks as well as bilateral agreements outside them.

Meanwhile, the two Asia-Pacific tracks are stimulating mutual progress. The TPP appears to have been motivated by Asian track agreements that have excluded the United States. The TPP, in turn, has led to vigorous Chinese efforts to accelerate the China-Korea negotiations and the CJK trilateral FTA. The 2011 Honolulu announcement that Canada, Japan and Mexico were interested in joining the TPP was quickly followed by announcements on the completion of a CJK investment treaty and the acceleration of the trilateral FTA study. Further, RCEP soon emerged as an ASEAN-centered response to the TPP. The United States, in turn, stepped up its efforts to attract additional partners to the TPP track.

The frameworks of the two tracks also seem to be converging. Recent trade agreements by the United States and Asian economies have more similar score structures than those concluded earlier, and both cover more overlapping areas. Indeed, agreements increasingly borrow language from each other. While not much is known so far about the prospective RCEP, ASEAN's published guidelines suggest an organization similar to that of the TPP. Both structures should include, for example, chapters on services, investment, intellectual property, competition and cooperation. Of course, the overlap is incomplete (for example, the RCEP guidelines omit mentioning labor and the environment) and more differences are sure to surface in detail. But viewed from a long-term perspective, the similarities suggest increasing agreement on the issues and approaches that now form the basis for economic integration.

Both tracks could represent breakthroughs in consolidating existing trade agreements—the complex and costly “noodle bowl” of rules and regulations that have emerged in Asia and elsewhere. Inconsistent rules of origin are particularly problematic, since they impose substantial compliance costs and generate incentives to diminish rather than increase productivity. The TPP will likely specify common rules of origin across the region, permitting cumulation of value originating across member countries. Hopefully RCEP will do likewise.

These long-term optimistic perspectives are not shared by many observers. Some see the tracks as confrontational, intended by China and the United States to harm each other. Competition between the tracks encourages hyperbole and cold-war references—for example, to motives such as encirclement, containment, and hegemony—and even warnings of “economic warfare within the Asia Pacific region” (Rowley 2011). Such narratives often serve unrelated political debates within countries, especially during elections, but they attract intense media attention. To be sure, business leaders across the region continue to support engagement and liberalization on both tracks. For example, in addition to supporting the TPP, the Wall Street Journal's CEO Council recently recommended a specific, new “economic cooperation agreement” with China that, short of a trade agreement, would promote cooperation and build confidence in the bilateral relationship.³

³ <http://online.wsj.com/article/SB10001424052970203699404577042461293566448.html>

The friction between the tracks can be most constructively interpreted as a contest over the ultimate template of regional integration. China and the United States are not likely to negotiate a free trade agreement now for many reasons, but they have much at stake in sustaining and deepening their economic partnership. Each will therefore champion regional agreements that reflect its future bargaining position on regional trade—China through provisions that favor manufactured products, and the United States through provisions that support its leading sectors in services, investment and intellectual property. As the two giants further adjust their economies and their international outlook as partners—albeit an important ones—in Asia’s rise, new possibilities should open for cooperation between them.⁴

II. Economic consequences

The effects of the tracks using a comprehensive model of regional integration are reported in Petri, Plummer and Zhai (2012) as well the website asiapacifictrade.org. We find that both tracks would generate significant benefits for members as well as reward enlargement for both current and future members. As the tracks gain momentum, they would also create incentives for consolidation. We do find evidence of trade diversion (losses for excluded economies, principally China on the TPP track), but benefits on both tracks predominantly result from trade creation and not diversion.

Modeling framework

The results are based on a 24-region, 18-sector computable general equilibrium (CGE) model developed by Zhai (2008). Such models have been long used to assess the implications of trade liberalization, but their results have been also widely debated. Three major concerns have arisen. CGE models appear to have: underestimated economic changes that resulted from large and ambitious agreements, such as NAFTA;⁵ missed important effects of such agreements, including on productivity and international investment; but also sometimes overestimated the effects of

⁴ <http://english.caixin.com/2011-11-25/100331554.html>

⁵ Kehoe (2005).

trade agreements by assuming more ambitious liberalization than is usually achieved in practice.⁶

We address these concerns with modeling innovations that hopefully provide more accurate results. We use a new type of trade model based on the empirical regularity that productivity differences among firms explain a substantial part of trade flows. This specification predicts changes in productivity in part because liberalization accelerates the growth of productive firms and the exit of unproductive ones, and predicts larger overall benefits than conventional approaches. We also attempt to model agreements more accurately than was possible in earlier studies. For example, we do not assume that new agreement will eliminate all bilateral barriers, but estimate partial reductions similar to those achieved in past FTAs. Finally, we account for existing agreements and calculate benefits from new agreements (say, the TPP) as incremental over previous agreements that already cover a trade relationship (say, the Australia-U.S. FTA).

The simulations begin with a projection for the world economy that incorporates all remaining implementation steps of agreements already concluded. Each track then assumes a timeline of new agreements and implementation schedules. These timelines assume rapid progress, as detailed in our publications, both in reaching agreements and in implementing them, in order to generate simulations that show the results in a reasonably short (2025) time frame. The objective is to answer “what if” questions about the consequences of policy choices.

Results

The empirical results confirm the value of Asia Pacific integration and the promising structure of both negotiation tracks (see Table 3). The differences in results are due to different assumptions about the membership of the tracks and the templates adopted in them. The templates used to represent the Asian and trans-Pacific tracks reflect recent ASEAN and US FTAs. A few broad conclusions are summarized below.

⁶ Productivity Commission, Australia (2010).

Table 3. Income gains under alternative scenarios

	GDP (\$bill) 2025	Income gain (USD2007 bill)				% Baseline GDP			
		TPP-11	TPP-16	RCEP	FTAAP	TPP-11	TPP-16	RCEP	FTAAP
Americas	24,867	48.8	160.8	2.5	373.3	0.20	0.65	0.01	1.50
Canada	1,978	7.0	12.4	-0.1	26.2	0.35	0.63	0.00	1.32
Chile	292	2.0	3.5	0.0	6.5	0.70	1.20	0.00	2.23
Mexico	2,004	13.1	31.2	2.8	67.7	0.65	1.56	0.14	3.38
Peru	320	2.8	5.4	0.0	6.3	0.87	1.69	-0.02	1.98
United States	20,273	23.9	108.2	-0.1	266.5	0.12	0.53	0.00	1.31
Asia	34,901	26.5	299.8	627.0	1354.3	0.08	0.86	1.80	3.88
Brunei	20	0.1	0.4	1.2	1.1	0.55	1.84	5.85	5.45
China	17,249	-20.2	-82.4	249.7	678.1	-0.12	-0.48	1.45	3.93
Hong Kong	406	-0.3	-1.3	46.8	84.9	-0.08	-0.32	11.54	20.91
India	5,233	-1.2	-6.9	91.3	-29.5	-0.02	-0.13	1.74	-0.56
Indonesia	1,549	-1.1	62.2	17.7	38.0	-0.07	4.02	1.14	2.45
Japan	5,338	-1.2	128.8	95.8	228.1	-0.02	2.41	1.79	4.27
Korea	2,117	-0.4	50.2	82.0	129.3	-0.02	2.37	3.87	6.11
Malaysia	431	20.8	30.1	14.2	38.4	4.81	6.98	3.29	8.90
Philippines	322	-0.5	22.1	7.6	15.9	-0.14	6.88	2.35	4.95
Singapore	415	5.1	12.3	2.4	13.6	1.23	2.97	0.58	3.28
Taiwan	840	0.2	-6.4	-16.1	53.0	0.02	-0.76	-1.92	6.31
Thailand	558	-0.7	42.5	15.5	27.4	-0.12	7.61	2.79	4.91
Vietnam	340	26.2	48.7	17.3	72.9	7.72	14.34	5.10	21.46
Other ASEAN	83	-0.3	-0.5	1.6	3.1	-0.30	-0.58	1.88	3.74
Oceania	1,634	5.7	14.6	21.7	32.1	0.35	0.89	1.33	1.97
Australia	1,433	2.8	9.8	19.8	26.4	0.20	0.68	1.38	1.84
New Zealand	201	2.9	4.7	1.9	5.8	1.43	2.36	0.92	2.86
Others	41,820	-6.6	-24.2	-6.8	162.0	-0.02	-0.06	-0.02	0.39
Europe	22,714	-1.1	-4.9	5.1	-32.6	0.00	-0.02	0.02	-0.14
Russia	2,865	-0.5	-3.0	-5.3	265.9	-0.02	-0.10	-0.18	9.28
ROW	16,241	-4.9	-16.3	-6.6	-71.4	-0.03	-0.10	-0.04	-0.44
WORLD	103,223	74.5	450.9	644.4	1921.7	0.07	0.44	0.62	1.86
<i>Memorandum</i>									
TPP-11	27,851	100.9	297.0	72.5	545.3	0.36	1.07	0.26	1.96
TPP-16	38,016	97.9	553.9	259.4	1071.3	0.26	1.46	0.68	2.66
RCEP	36,535	32.2	314.4	648.6	1695.0	0.09	0.86	1.78	3.79
APEC	58,951	81.9	479.5	553.0	2165.2	0.14	0.81	0.94	3.48

Note: from scenarios reported on asiapacifictrade.org.

1. Asia-Pacific-wide integration promises large income gains reaching \$1.9 trillion, or 1.9 percent of world GDP in 2025. In other words, Asia Pacific integration is a Doha-scale project. Although the region accounts for only part of world trade, its potential integration scenarios offer deeper and wider liberalization than is expected from global agreements.
2. The separate tracks also promise substantial benefits. Their scale is roughly similar, with the TPP (in its 16-economy configuration) offering benefits of \$451 billion vs. \$644 billion for RCEP. Although the TPP-16 covers more trade than RCEP, much of this trade is already subject to low barriers (especially in the advanced countries) and to prior FTAs among members. Initial barriers are on average higher in RCEP countries, and the trade among the largest economies (China, India, Japan and Korea) is not yet covered by FTAs.
3. Benefits increase with the scale of the integration project. For example, as the TPP expands from 11 members to 16 (by adding Indonesia, Japan, Korea, the Philippines and Thailand), benefits would grow from \$75 billion to \$451 billion in 2025. On the Asian track, moving from an ASEAN+3 to an ASEAN+6 raises gains from \$500 billion to \$644 billion in 2025 (these results are reported on our website).
4. The TPP track is likely to favor economies that are relatively small and initially protected, and do not yet have an FTA with the United States. The five largest gainers, in percentage terms, would be ASEAN economies, ranging from 4% for Indonesia to 14% for Vietnam.
5. The Asian track is likely to favor China, India, Japan and Korea, since their trade relations are not covered by current FTAs, with \$519 billion of the \$644 in total gains flowing to these countries. In contrast, the ASEAN economies would gain from RCEP only to the extent that the agreement improves the rules of integration over current overlapping FTAs, or because its cumulation rules allow greater utilization of trade agreements. The model predicts these effects to be much smaller than the trade-creating benefits among non-ASEAN countries.
6. Due to points 4 and 5 above, most potential members of both TPP-16 and RCEP are likely to find the TPP more beneficial. This is true for ASEAN countries as well as for Japan and New

Zealand. However, RCEP would generate larger benefits Korea and Australia, since both already have FTAs with the United States. Note, however, that all of these countries could join both tracks and benefit from both integration schemes.

7. China and the United States would gain substantially more from an inclusive FTAAP agreement than from the sub-regional tracks in which they participate. The reason is access to each other's markets. For China, FTAAP benefits would be 2.7 times as large as in RCEP, and for the United States the gains would be 2.5 times as large as in the TPP-16.
8. We also estimate that the gains from the FTAAP would be larger with the template projected for the TPP rather than RCEP (these results are reported in Petri, Plummer and Zhai 2012). Global FTAAP benefits were estimated at \$2.4 trillion under the TPP template, \$1.3 trillion under the RCEP template, and \$1.9 under a template that averages the two. This ranking would apply even to China's gains; although the Asian template more closely mirrors China's comparative advantage, the greater depth of liberalization under the TPP would generate larger benefits.

Overall, the results suggest strongly positive-sum outcomes, and especially so for wider and deeper regional liberalization. As the next section argues, they also suggest significant economic incentives for forward momentum on both tracks.

Strategic consequences

The results indicate that the tracks represent complex strategic interactions among Asia Pacific economies. In the early stages this "game" the agreements offer preferential access to the markets of the United States and China, respectively, and hence yield important gains for countries that do not already enjoy such access (for example, Vietnam and Malaysia in the case of the TPP, and Korea and Australia in the case of RCEP). China and the United States would benefit only modestly in this stage; their interest is motivated by longer term gains from the contest of templates.

In a middle stage of the game, the agreements are likely to widen to several large economies, such as Korea and Japan. Benefits would expand accordingly. Countries that join both tracks would gain the most and both tracks are likely to make efforts to secure the participation of most countries. By the end of this middle stage—2020 under our assumptions—most Asia Pacific economies should have preferential access to most Asia Pacific markets. They could still gain more from a region-wide FTAAP, but membership in both groups would deliver benefits that are nearly as great. For example, Japan and Korea would achieve 91% and 90%, respectively, of the potential gains from region-wide free trade by simply participating on both tracks.

In the final stage, China and the United States would be left among the few economies *without* preferential access to both of their markets. For them, the grand prize would be a consolidated agreement. The FTAAP would offer China and the United States nearly three times the benefits of the separate tracks. Reaching a consolidated agreement, say a decade from now, could be easier than now. By then, Chinese per capita incomes will have roughly doubled, and ongoing reforms should enable China to meet many TPP provisions. The US too will have adjusted to changing global patterns of economic competition and power. Much will still depend on the chemistry of China-US political relationships, but the case for region-wide economic integration will be increasingly compelling.

If China and the United States do agree on a framework embracing all APEC economies,⁷ the annual benefits would rise into the \$1.3-2.4 trillion range, depending on the template used, represent up to two percent of world GDP in 2025. Much of these gains would accrue to China and the United States, providing them with strong incentives to move to this final stage of integration. And the vast majority of the gains would reflect trade-creation rather than the diversion of benefits from the rest of the world.

⁷ The 21 economies of APEC include members of both tracks, plus Russia, Papua New Guinea and Chinese Taipei. We also include small ASEAN member states that are not yet APEC members: Cambodia, Laos and Myanmar.

III. Policy implications

In sum, economic integration along the Asian and Trans-Pacific tracks promises large economic gains. The current Asian and trans-Pacific negotiating tracks are likely to accelerate progress toward this end by offering significant gains and stimulating mutual progress. Later, they will creative incentives for consolidation. Importantly, they will also establish templates that help to shape the regional and perhaps global trading system of the future. In general, the benefits will depend on the scale of the agreements reached and the ambition of the templates used.

The main source of tension in the scenarios is the choice between rigorous provisions and wide regional coverage. A high quality template, such as the one emerging on the Trans-Pacific track, should yield greater gains, but it could make it harder to attract region-wide membership. With this tradeoff in mind, leaders and negotiators will need to seek a careful balance between the rigor and scope of their agreements.

An additional concern is that the contest of templates between the tracks could lead to hardened positions that preclude later enlargement and convergence. That outcome would be especially harmful to China and the United States, since these countries will depend on region-wide integration to realize most of their gains. Various factors could improve the prospects for Asia Pacific integration in the future and, we argue, that the benefits to China and the United States from consolidating the tracks should increase over time.

Effective, forward-looking policies are needed to steer regional trade toward the best outcomes. Even as they seek progress on their respective tracks, negotiators should reaffirm the goal of region-wide free trade and establish consultations between the tracks to promote it. In addition, they should seek standards and provisions with the goal of enlargement and eventual consolidation in mind. Importantly, a “third track” of discussions should be established between China and the United States to chip away at differences (say, through devises such as the proposed Bilateral Investment Treaty) that help to make future regional agreements viable.

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