Asia-Pacific Megaregional Free Trade Agreements: Fostering Global Supply Chains?

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Paper Presented at the 2014 APEC Workshop on Advancing REI in the GVC Era
Taipei, September 29, 2014

Abstract

One of the selling points behind larger preferential trade agreements (PTAs) or free trade agreements (FTAs) is the potential to encourage the spread of global value chains (GVCs). These supply chains are increasingly critical to the globalized economy. Large GVC operators may include up to 15,000 firms in their networks spread across multiple countries. PTAs have the potential to lower barriers to trade for GVC operators. This includes not just reductions in tariffs, but significantly reduce costs by speeding up customs and other trade facilitation measures. Many GVCs are also sophisticated service suppliers that benefit from services liberalization in advanced PTAs. The highest quality PTAs are increasingly adding new features like regulatory harmonization that may also foster GVC growth in partner countries. However, not every PTA in Asia is equally helpful in promoting GVCs. This paper examines the current crop of Asian PTAs to determine which are more likely to push this latest wave of globalization further faster and explores the mechanisms that are most helpful for GVC growth.

Introduction

The 2008 economic crisis has lead many countries around the world to impose different forms of protection from competition from foreign products. Since January 2008, more than 5250 different trade defense measures have been taken to protect domestic markets from foreign competition.¹ Politicians around the world have extolled the virtues of exports and moaned about the impact of imports.

In the increasingly globalized world of today, however, shutting off trade or limiting imports is simply counterproductive at best and downright harmful at worst. More and more trade is taking place as part of global value chains

¹ This includes more than 1000 trade defense measures (anti-dumping, countervailing duties and safeguards), more than 500 tariff measures, over 200 export restrictions and more than 200 local content requirements. All measures counted by Global Trade Alert. Shown at http://www.globaltradealert.org/measure Accessed September 16, 2014.
(GVCs) for both goods and services. However, the regimes that govern trade have not quite caught up to the reality on the ground.

The shifting nature of trade in value chains also coincides with a rising trend of proliferating preferential trade arrangements in Asia. Prior to the year 2000, Asian countries had very few preferential trade agreements (PTAs). A dozen years later, 72 PTAs had been concluded with 53 more under negotiation and 34 proposed. The bulk of these agreements have been bilateral, but a growing share is plurilateral (between more than two partners).

It could certainly be argued that the ideal way to handle GVCs is through a robust agreement at the multilateral level. After all, global chains operate most smoothly in a world of global rules rather than a patchwork of individual state rules and regulations that may or may not match up with the provisions anywhere else. However, given the current situation in the World Trade Organization (WTO) and the impasse in negotiations after more than a decade of discussions, an update of the global rulebook does not look likely any time soon. The last rules were created in 1993 under the Uruguay Round discussions and the patterns of trade have changed dramatically in the decades since then. It has therefore fallen to officials to sort out provisions for greater market access at the bilateral or regional level in PTAs instead.

### Changing Patterns of Trade: The Rise of Global Value Chains

Trade has been conducted across international borders for centuries. The Egyptians, Romans and Greeks imported raw materials for use in a variety of applications. Cargo on the Silk Road included such diverse goods as textiles, spices and porcelain. The industrial revolution speeded up the process, dramatically dropping the costs associated with the movement of goods around the world. As a result, global trade exploded in what Richard Baldwin has called the “first unbundling” of trade.

But it was the “second unbundling” of trade where things began to get really interesting. This new phase saw both the continued drop in prices of transportation and communication coupled with wage disparities that made it suddenly profitable to disperse production globally. This second unbundling is different from simply sourcing inputs or raw materials from different locations or selling the final products in different markets. Instead, the entire process of producing products has been globally fragmented. As this paper highlights below, this includes not just goods but also services.

Many people believe that global supply chains are simply the extension of what has gone on before—except that the level of fragmentation has shifted

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2 Among the following countries: Australia; Brunei; Cambodia; People’s Republic of China; Hong Kong, China; India; Indonesia; Japan; Republic of Korea; Lao PDR; Malaysia; Myanmar; New Zealand; Philippines, Singapore; Taipei, China; Thailand; and Vietnam. February 2013 data collected from Asian Development Bank, Asian Regional Integration Center as shown in Richard Baldwin and Masahiro Kawai, 2013, “Multilateralizing Asian Regionalism,” ADBI Working Paper Series No. 431, (Tokyo: Asian Development Bank Institute).

downward, ie, the dispersion of production of parts and components rather than just final products. This does not fully capture the extent to which GVCs are a new phenomenon. It is not just that parts and components are themselves sourced, produced and distributed in a geographically fragmented manner, but that the entire approach to the production of goods and services has been fundamentally broken apart and put back together in a new way. Lead firms, especially, can literally use the world as their “oyster” precisely placing only the step (or steps) of their processes in one space and rely on some other physical space to complete some other aspect of the process.

This means that there are at least two key elements of GVCs to consider. First, is the ever-finer breakdown of processes or steps or stages of production. In the past, firms often completed many tasks in-house for which they were not particularly competitive. In a GVC world, firms will increasingly source partners to complete any task (large or small) to meet the demands of competition. Second, these partners can be widely geographically dispersed. Changes in transportation and telecommunications have made it economically and physically viable for firms to count on partners in countries and regions that were previously unable to participate in marketplaces in the past.

The New World of GVCs

Research on GVCs is in its relative infancy. We still do not have a particularly good understanding of the range and spread of GVCs. We do not, as an example, really understand the differences between supply chains built for cold storage and those that are not. We have a particularly poor knowledge of service supply chains and the role of services in all chains.

GVCs are not simply found in goods trade or just in manufacturing. They exist in these settings, of course. But they can also be found in the sourcing of raw materials at the start of the chain. Depending on how a chain is measured, they can also include retail sales and after-market service of products as well. GVCs could be thought to include not just the products produced but also the logistics and distribution systems necessary to move the products as well as the financial products needed along the way.

Different scholars slice GVCs differently. Some focus on just certain aspects of supply chains. Others examine forward linkages and some go further backwards. Because the field is so new, terminology has not yet been sorted out. Researchers have been studying GVCs across scholarly field lines with particular interest from economists and business theorists. These scholars often use alternate labels to describe apparently similar phenomenon. This has muddied the waters even further.

Another problem in studying GVCs has been a poor grasp of data that has made it difficult to recognize the changing nature of trade. Because statistics offices have traditionally measured trade in final goods, this has severely

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4 For a nice review of the literature, see Albert Park, Gaurav Nayyar, Patrick Low, 2013, Supply Chain Perspectives and Issues (Geneva: World Trade Organization). Their review argues that the literature did not take off until the year 2000 (p. 13).

5 I will return to this point later. See Patrick Low, “The Role of Services,” in Elms and Low (eds.), Global Value Chains in a Changing World.
handicapped the study of globalized, fragmented trade. It was only in 2012/2013, with the creation of new datasets by the OECD and the World Trade Organization (WTO) that researchers and trade officials have begun to see more clearly how GVCs have altered trade patterns.\textsuperscript{6}

In the past, trade was measured in final goods crossing borders. To simplify greatly, this meant that products like a MacBook Air that was assembled in China and sold in Singapore was recorded as a good sold by China to Singapore. But the reality of this sale is much more complex. Depending on how far back we want to go in the value chain, we could include the sourcing of the basic raw materials for this computer from the aluminum in the casing to the plastic in the keyboard. We could also go upstream to include the downloading of software security updates to the system software that take place weekly when the system updates itself.

But we will focus here on the shipping of the basic laptop from China to Singapore. The laptop contains hundreds or even thousands of parts and components large and small sourced from all over, including the screen, keyboard, power cord, and internal circuitry including the hard disk drive.\textsuperscript{7} These components may themselves have crossed international borders multiple times before the final assembly in China into the laptop. Each time they cross a border, trade statistics picks them up as a good imported/exported from one country to another. This method, however, seriously overstates the final goods included in the laptop—each component is likely to have been at least double or triple counted by the data.

It also dramatically overstates the amount of trade gained by China (especially) as the final assembler at the end of the process. This is because the entire amount of the laptop is credited to the Chinese trade statistics as an export, even if China only added a small portion to the overall laptop (because the components were largely sourced from outside China).

Finally, counting trade in this manner skews the results because it counts only trade in goods and not trade in services (or anything else) that matters tremendously in a GVC world. For example, recording the whole amount of the MacBook Air to China does not take into account the work done by Apple in California in either developing or marketing the laptop. But much of the actual value reflected in the final price paid for the laptop in Singapore is embedded in the design and marketing done by Apple. Very little of the price paid in Singapore is a result of the assembly work on the computer done in China.

The new method of collecting trade data called “trade in value added” (TIVA) or trade in tasks, is intended to make a start on correcting these

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\textsuperscript{6} See 2011, \textit{Trade Patterns and Global Value Chains in Asia: From Trade in Goods to Trade in Tasks}, (Geneva: WTO). See also the WTO’s Made in the World Initiative (MIWI) and the OECD’s Trade in Value Added database at: http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO

problems. Using input-output tables for an expanding set of countries, it is possible to see a completely different picture of trade patterns in the world today. This new picture more accurately reflects trade in value-added terms. Using better data should yield more realistic pictures of the actual state of trade today. Such information is critical to the creation of a trade regime that fosters and encourages the growth of GVCs. Because this research is still in its infancy, it is not entirely possible to forecast the impact of how revisions in statistics will play out in the end. However, if governments are serious about catching up policy levers to match the business reality in large parts of the world today, they will need to start reflecting on changes to trade rules.

New World GVCs Collide with Old World Trade Rules

Firms trying to take advantage of a GVC world can quickly run into a host of obstacles. Many of the problems they face stem from trade rules at the domestic, regional or global level that do not match the new patterns of trade. The remainder of this paper sketches out some of the challenges that firms face—some of which are highlighted or confirmed by the new trade data.

To take the most straightforward example, companies like Apple face surprisingly serious costs related to tariffs. Tariffs can be thought of as taxes on imports. Governments have traditionally used tariffs to protect domestic markets from competition. Over the past 60 years, however, repeated rounds of negotiations in the global trade regime of the General Agreements on Tariffs and Trade (GATT) and now the World Trade Organization (WTO), have dramatically reduced the overall tariff levels paid by firms.³⁸ In the electronics sector in particular, many items are actually subject to no tariffs at all or extremely low tariffs as a result of the Information Technology Agreement (ITA) in the GATT/WTO.³⁹ In Asia, which leads the way in the production of electronic goods, Hong Kong and Singapore are essentially tariff-free and many of the high-income countries in the region allow more than two-thirds of non-agricultural goods in

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³⁸ There are many caveats that could be applied to this statement—it applies only to countries that are members of the GATT/WTO; developed countries have cut tariffs much more than developing country members; industrial goods have much lower tariffs than agricultural goods; and so forth. The WTO notes that for most traded items the most favored nation (MFN) rates are low or near zero. See, for example, World Trade Report 2011: The WTO and Preferential Trade Agreements: From Co-Existence to Coherence (Geneva: WTO), 73.

tariff-free. As a result, research might have thought that Apple and other computer manufacturers were not badly affected by tariffs.

However, new research on tariffs using input-output tables has shown the opposite. Tariffs are leveled on the gross value of the good and not on the value-added amount. Firms with long international chains can face significant costs from even very low tariffs. Ferrantino showed that a 10 percent tariff across a five stage chain results in a tariff equivalent of 34 percent—and doubling the chain again drives tariff levels up to the equivalent of 75 percent.11

These embedded tariffs can be modeled. Robert Koopman at the United States International Trade Commission has been working on the problem of capturing the effective tariff rate. Koopman and his colleagues have reported that the United States effective rate is 17 percent higher than the nominal rate, 71 percent higher in Hong Kong and 171 percent higher in Mexico.12 The difference between these figures is largely because developing countries tend to produce products that incorporate more intermediate goods from overseas.

It is, of course, possible that Apple is not badly harmed by tariffs since many of the parts and components in a laptop computer are duty free under the ITA or various preferential trade agreements (PTAs) between key suppliers in Apple’s value chains. But, even PTAs are no guarantee that tariffs will be reduced. Sebastien Miroudot has shown how the amplification of tariffs still takes place under PTAs in Asia.13

The bottom line is this: even if the tariffs are extremely low (say two percent) on some of the parts or components, when compounded over the movement of the finished product, they can still add up to a significant cost in the final good. For products that face larger tariffs at the outset than the information technology goods covered under the ITA, the situation is magnified. Given the relatively high tariff levels remaining for agricultural products,14 value chains for food products (and especially for processed food products) can be badly harmed by tariffs.

Another traditional trade rule that causes significant problems for GVC firms is tariff escalation. Under tariff escalation, countries set relatively low tariffs for trade in raw, unprocessed materials but higher tariffs for goods that have been partially processed. As an example, raw coffee beans might be subject to a relatively low tariff rate of 5 percent. But roasted coffee beans will face

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14 Unlike industrial goods where tariff reductions began as far back as the 1940s, agricultural products were not brought into the GATT/WTO system until the Uruguay Round for tariff (and subsidy) reductions under the Agreement on Agriculture (AoA). Members were not required to cut tariffs until 1995.
higher tariffs and ground coffee beans higher still. Finally, bottled coffee beverages like a Starbucks Frappuccino will face the highest tariff of all. These trade rules hamper the flow of trade for GVCs. They make it difficult for businesses to source products from the geographic spaces where they would otherwise be quite price competitive in the absence of tariff escalation. Again, these rules tend to hit food chains harder than non-food chains.

Other rules that escalate costs for supply chains are unnecessary and duplicative costs associated with the movement of goods across borders. For example, any delay in processing paperwork for customs that results in a shipment being stuck at a border adds to the transaction costs embedded in the final product. Like tariffs, the costs in the final product of each of these delays may be compounded in a non-linear fashion across each step or stage of the chain. The costs can be measured in both time and money.

One result of problems in trade facilitation is that firms are often forced to carry more inventory than they would otherwise opt to hold. A decision to maintain inventory brings with it a host of costs including warehousing and the carrying cost of holding unsold stock. Hummels and Schaur estimate that the costs of holding onto stock per day is equal to an additional tariff of 0.6-2.1 percent.15 Again, at the risk of sounding like a broken record, if every parts supplier in the chain faces similar risks of customs delays and is forced to hold extra stock, these costs can be compounded for each and every part and component in the chain.

Designing New Rules for a New World

Trade in Goods: Tariffs and Rules of Origin

Tariff barriers have always been problematic. But in a world of GVCs, they have become more harmful than ever. This is particularly true for developing countries and firms that wish to plug into chains by supplying parts and components.16 Supplying what used to be called intermediate goods while operating under tariff barriers will prove increasingly difficult. Firms will simply source these parts or components from other suppliers who do not face similar tariff costs.

One solution to the problem of tariff barriers is to take advantage of preferential trade agreements that generally result in lower tariffs or even zero tariffs. PTAs are signed between two or more partners and are designed to facilitate trade between the parties. However, because the members want to ensure that only members receive benefits (and keep out non-members), officials also have to create specific rules to guarantee that products cross the border are “from” a member if the firm wants to take advantage of the negotiated tariff preferences.

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16 Developing countries tend to have a higher percentage of foreign value-added content embedded in their products. See Koopman, Robert; Zhi Wang, and Shang-Jin Wei, 2013 forthcoming, “Tracing Value-Added and Double Counting in Gross Exports,” The American Economic Review.
Note that these rules, called rules of origin (ROOs), can be different from the label sewn or pasted on the good that says, “Made in Country X.” For trade flowing across borders, customs officials have specific meanings when determining the origin of a good. What matters here is that the criteria for meeting these rules change from agreement to agreement and, sometimes, from good to good within an agreement. This can make it incredibly difficult for firms to demonstrate that their products meet the rules and qualify for the benefits in terms of lower tariffs or no tariffs at all (the so-called duty free access).

Because tariffs and ROOs work in tandem in a PTA, it is important to examine the two together to decide how open or closed two markets are to one another. It is possible to have zero tariffs but create such onerous ROOs that hardly any goods trade qualifies for duty free access. Or, alternatively, a liberal ROO may allow greater market access than a relatively high remaining tariff would suggest as firms find it easy to qualify for preferences.

People have pointed out the difficulties of using ROOs for some time now.\textsuperscript{17} What is new, however, in a world with more and more GVCs is that ROOs can ensnare a greater portion of trade in chains. Especially problematic for GVC companies are ROOs that change across different PTAs. As an example, consider the different ROOs for just one Asian product—automobiles.\textsuperscript{18} Under the ASEAN Free Trade Area (AFTA), and ASEAN-China the ROO is the same: 40 percent regional value content (RVC). Japan-Thailand allows either 40 percent RVC or another measurement method, change in tariff classification (CTC).\textsuperscript{19} The RVC requirement for autos in ASEAN-Korea rises to 45 percent. And under Japan-Malaysia, it takes either 60 percent RVC or CTC to qualify for the low tariffs under this agreement.

This all means that an automobile manufacturer located in Asia needs to think carefully about the final market for each car rolling off the assembly line because, depending on the destination, different parts and components may be


\textsuperscript{19} CTC, in brief, requires that when a firm puts together the parts or components into something else, the new product will be classified as a good with a different tariff code. For example, oranges are HS chapter 8, while crushing them into orange juice changes the heading to HS chapter 20. For some goods, CTC is easier to meet. For others, RVC is easier (although firms often complain about the amount of data needed to prove value content). In some PTAs, a third kind of ROO is used, especially for chemical products, that specifies the kind of process used to produce the good. Finally, there is another kind of ROO, wholly obtained, for products that are grown, harvested or mined from a country—and for which there is usually no dispute about the origin.
required from alternate geographic locations to meet the content requirements under ROOs for various PTAs. To reach the threshold of 40 or 45 or, worst of all, 60 percent content, it requires the auto manufacturer to source at least 40-60 percent of the value of the final product from the PTA partner(s) to take advantage of any tariff preferences. Parts or components from any non-PTA partner will not count towards meeting the content requirement.

**Trade Facilitation**

One important feature of a GVC world is the search for a “just right fit:” doing the right slice of the chain in the correct place. Because transportation and telecommunications costs are comparatively low, companies can source slices anywhere in the world. One result is that labor costs, especially for manufacturing chains, continue to fall. JETRO interviewed Japanese affiliated firms in Asia and found that, out of 1763 firms across a range of industries, labor accounted for only 17.2 percent of their costs. The bulk of costs, 63.3 percent, come from parts and raw materials. This makes any impediment at the border especially problematic since it affects the largest component of company costs.

The same JETRO survey also highlighted the importance of lowering costs (cited by 86.3 percent of respondents) and shortening lead time (61 percent) as the most critical factors in increasing future procurement of raw materials and parts.

To the extent that PTAs discuss trade facilitation, many do so only in the most broad and general terms, often with no specific timelines, targets or objectives outlined. This is particularly true for the various ASEAN+One agreements in Asia that bind the 10 members of the Association of Southeast Asian Nations (ASEAN) together with their Dialogue Partners elsewhere in Asia.

Several solutions could be incorporated into PTAs that would help GVCs in the future. For example, officials could create a set of performance indicators for customs procedures and cooperation measures that would provide feedback on the implementation of clear, transparent goals and objectives to facilitate trade at the border. Indicators could also be included to spur the introduction of technological innovations (like single windows to speed the processing of paperwork) or necessary legal changes.

Of key importance for GVCs, and business in general, are the creation of a clear, transparent, simple and predictable set of processes for moving cargo across borders as well as adequate procedures for communicating and consulting with industry on any planned changes to these processes. The larger the set of countries with similar processes, rules, procedures, standards and technologies, the better for business as costs are reduced.

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21 There are currently 5 ASEAN+1 agreements: with Japan, South Korea, China, India and Australia/ASEAN/New Zealand (AANZFTA). The only one that includes trade facilitation in any form is AANZFTA.

22 This is why the Bali package of measures for trade facilitation, agreed upon by the WTO membership in December 2013 is so important. Unfortunately, implementation of the deal—expected to move forward in July 2014—has been delayed.
Critical Role of Services and Investment

In the past, officials used to wrestle with market access agreements for goods separately from services and investment. In many preferential trade agreements, particularly between developing countries, the sections on services and investment might remain “under negotiation” for years and years. Services markets often have high barriers of various sorts and strong opposition to opening the market for foreign competition, even to a PTA partner.

However, in a world of growing GVCs, services and investment cannot be decoupled from goods markets. The input-output tables make very clear that trade in services is increasingly up to half of the value of trade overall. In addition, some service sectors contribute high value added content to the final goods products.

The scope for new initiatives in services and investment is quite broad, particularly in developing countries. As an example of the kinds of services that could usefully be encouraged, logistics and package delivery services are often tightly controlled in many countries. The services performed by logistics companies are critical to GVC firms, including warehousing, transportation, delivery, processing for customs, and even procurement of items from suppliers. Each step of this process may be limited by a host of regulations and prohibitions on foreign firms or foreign investment that drives up costs and drives out foreign service logistics providers. This limits competition in this key sector and raises costs for GVC firms across the board.

As a starting point, services could usefully be liberalized by sector or subsector across all modes of supply in a PTA. Currently, countries often will open up only one or two methods of delivering a service for foreign competition, even to a PTA partner. But for businesses, this distinction often makes no sense at all as they typically offer services across all four modes simultaneously.

More than specific barriers to entry, however, firms often face regulatory hurdles that make it challenging to operate in foreign markets. For GVCs, the greatest benefits could come from improved harmonization. As an example, firms often run into difficulties when the regulations put in place in one jurisdiction run counter to the regulations of another.

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23 The WTO Secretariat estimated that services made up 23 percent of world exports based on gross trade terms in 2008, but this figure jumped to 45 percent when calculated in value-added terms. See Patrick Low, “The Role of Services in Global Value Chains,” in Elms and Low (eds.) 2013, Global Value Chains in a Changing World, 62.

24 The modes of supply came about in the Uruguay Round negotiations of the GATT/WTO where officials were wrestling with how to discuss market opening for services. Because ultimately, services barriers are more about regulations on services, officials finally decided to divide services into four “modes” depending on how a service could be supplied across a border. In mode 1, only the service moves (like services over the internet or via telephone). In mode 2, the customer or consumer of the service moves over a border to use the service (like someone who travels for tourism or to have surgery in a hospital overseas). In mode 3, the service moves to the customer (in the form of an investment like the building of a foreign hospital in the customer’s home country). Finally, mode 4 is about the temporary movement of people (the doctor to supply surgery in the foreign hospital but only for a limited time). GATT/WTO rules allow discrimination in services. Therefore, a country can open only some or none of these modes of supply to foreign service providers for each of 12 sectors and subsectors.
**Standards**

An emerging new area of concern for GVCs is the use of standards and regulations that limit the ease of movement for goods across borders. Suppliers of electronics need to provide evidence of safety testing and certification that meets the demands of the foreign government before the product can be sold on the market. But often, the testing regimes are unnecessarily duplicative. Food and pharmaceuticals often face daunting safety hurdles that also require new testing and certification. The requirements for testing can vary from country to country and market to market. Each new test adds an additional burden on a firm attempting to plug into a GVC network.25

This is not to say that product standards are not necessary or that food or medicines should never be evaluated for safety. In addition to general ethical considerations, GATT/WTO rules guarantee every member the right to regulate in the interests of human, animal and plant life and health. Instead, the point is that some of the required testing may be a barrier to trade. In many cases, countries could recognize the standards, testing or certification done in one country as equivalent to the requirements of the other. Simply reaffirming WTO commitments in a PTA is not sufficient.

**Implementing New Rules**

The newest generation of PTAs claims to be GVC-friendly. However, no matter how comprehensive and deep, a bilateral agreement is problematic for supply chains. The specific benefits apply only to the two partners and limit the geographic scope for placing tasks in the best possible location.

It is true that some of the benefits of bilateral agreements have spillover effects to non-members. For example, certain reforms to customs procedures designed to speed the movement of goods across borders or the construction of new hard infrastructure in ports or cargo clearance areas cannot be confined only to PTA parties. Likewise, changes in regulatory regimes or licensing rules that allow for increased participation in some service sectors may also apply to all foreign providers. Better enforcement of intellectual property or property rights in general may encourage inward investment from across a range of countries.

However, the purpose of a PTA is to provide benefits to partners that non-members do not receive. Therefore, much of the value of an agreement accrues to the parties who craft the terms to suit their needs. In a GVC world, limiting these benefits to two countries is insufficient. Bigger, more comprehensive agreements need more members to really begin to pay off for supply chains. Only then can firms take advantage of lower costs and begin to source slices of the value chain more precisely in the locations where costs and skills are best suited for the task.

It could be argued that one of the biggest benefits of the European Union’s (EU) integration efforts has been the unleashing of a common market for supply

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chains. Location matters. Of the 100 largest car parts suppliers for the EU, 87 percent are sourced within the EU.\textsuperscript{26}

**The Trans-Pacific Partnership (TPP)**

Outside of the EU, the most ambitious PTA to date has been the Trans-Pacific Partnership (TPP) agreement negotiations. These talks, started in March 2010, now include twelve members: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam. The TPP is not explicitly about GVCs. The objective has always been to create a “21\textsuperscript{st} century, high quality” agreement.\textsuperscript{27} The TPP includes nearly 30 chapters and is broader in scope and deeper than nearly any agreement attempted to date (outside of the EU).

There are some GVC-specific elements of the TPP. This includes provisions for supply chains, especially relating to rules around logistics operators and express delivery. Officials have wrestled over trade facilitation measures.

The agreement is designed to have all tariffs drop to zero by the end of the implementation period.\textsuperscript{28} This is very important for GVCs, especially for raw materials that will no longer be subject to tariff escalation. On the less positive side, however, officials were not able to create clean, simple ROOs. Instead, they have created product-specific ROOs, often with fairly high levels of content and less-than-hoped-for levels of regional cumulation (the ability to count content from all TPP members in the final content figures).\textsuperscript{29}

Paradoxically, for smaller firms, these ROOs may not prove especially problematic. If a firm only exports a handful of items to one or two locations, the TPP may prove especially helpful and not overly difficult to use. For large MNCs with extensive inventories, however, product-specific ROOs will keep some staff members (and an army of lawyers and consulting companies) gainfully employed for years—as they will need to go through each product for each


\textsuperscript{27} The book, The Trans-Pacific Partnership: A Quest for a Twenty-first Century Trade Agreement, C.L.Lim, Deborah Elms, and Patrick Low (eds.) 2011, (Cambridge: Cambridge University Press) is an investigation into this claim.

\textsuperscript{28} Of course, the deal is not yet done (as of September 2014). In the end, it is possible that a very small number of tariff lines at the domestic heading level will not reach zero—however, the coverage will still be above 98 or 99 percent which is well above most PTAs. Implementation is also not supposed to stretch beyond seven years for developed economies and ten years for developing economies. Again, compared to the alternatives, this is quite good.

\textsuperscript{29} Cumulation is likely to be frustratingly difficult for many GVC firms when rules are product-specific. For complex products, using the TPP tariff benefits will require determining whether or not each component meets individual ROOs as well as the final product.
possible TPP member destination and whether or not it meets (or could eventually meet) origin criteria for the TPP preferences.\textsuperscript{30}

As with any PTA, the agreement only works when shipping a good to a member country. However, since the current 12 members include an increasing number of firms that are already plugging into GVCs across a range of products for final export into key final markets like the United States and Japan, the TPP is poised to become an important economic platform. Further, the TPP is positioned to expand in the future, having already expanded from the original four members to the current 12.\textsuperscript{31} If the TPP comes close to the aspirational goal of becoming a path to the Free Trade Area of the Asia-Pacific (FTAAP) with the 21 members of the Asia Pacific Economic Cooperation (APEC), the potential for GVC firms to use the goods preferences granted by the TPP will be significant.

On services, the TPP is perhaps a bit less ambitious than the complete market opening envisaged for goods. In part this is because many of the TPP member countries have significant obstacles to foreign firm participation in services that would need to be removed.\textsuperscript{32} However, the TPP does go farther in opening the service sector than many comparable PTAs—particularly since many PTAs between developing countries do not have any service commitments at all or service commitments that merely affirm existing WTO pledges or barely move beyond such promises. The TPP, by contrast, has opened services by using a “negative list.” Under this approach to negotiating, unless a country specifically objects to a specific sector or subsector being opened to foreign competition by PTA partner firms, it is automatically opened for competition.\textsuperscript{33}

A negative list does not inevitably result in more market opening. It is possible to create a negative list and write down, or schedule, every single service sector such that not one is actually open for competition. However, officials have been keenly aware of the objective to open as many sectors as possible. Liberalization has therefore proceeded more fully than in many PTAs in the past.

The TPP also includes several other chapters intended to address the specific concerns of GVCs, including harmonization of standards. This harmonization will take place in a variety of settings. There is a chapter specifically on regulatory coherence that lays out an institutional framework for regulatory cooperation in the future. In individual chapters, the TPP members

\textsuperscript{30} Pity the folks at Dow Chemical or a large textile firm the most! TPP rules for chemicals and textiles are especially complicated. Some of the process rules are likely to be hard for smaller firms to use as well.


\textsuperscript{32} Unlike trade in goods where repeated rounds of negotiations in the GATT reduced tariff barriers, services were not brought into the GATT/WTO until the Uruguay Round in the 1980s. Also unlike goods, GATT/WTO members are allowed to continue to discriminate against foreign service suppliers (as long as such discriminatory actions are noted).

\textsuperscript{33} The alternative, more commonly used method is called a “positive list” in which only the listed sectors are opened for foreign competition. This is the approach used by the WTO.
have focused attention on bringing standards and regulations into coherence whenever possible, especially for agricultural products in the sanitary and phytosanitary (SPS) chapter and for other goods in the technical barriers to trade (TBT) chapter. These individual chapters include both new rules that go beyond existing WTO commitments as well as procedures for increasing transparency of standards going forward.

The Regional Comprehensive Economic Partnership (RCEP)

There is an alternative agreement to the TPP underway in Asia, the Regional Comprehensive Economic Partnership (RCEP). RCEP brings together the 10 countries of the Association of Southeast Asian Nations (ASEAN) with what are called the Dialogue Partners. These are the six countries that have existing PTA agreements with ASEAN: Australia, China, India, Japan, New Zealand and South Korea. Together, the 16 countries are working on a new agreement for Asia.

Although ASEAN already has five agreements with the Dialogue Partners, there is wide variation between these existing PTAs. For example, while Australia/ASEAN/New Zealand (AANZFTA) is the most comprehensive with chapters on goods, services and investment, ASEAN-Japan still covers only goods and ASEAN-India effectively covers only goods as the services and investment chapters have only just been ratified. Even within the five agreements, the scale and scope of coverage for each member differs.

The RCEP is intended to pull these various ASEAN+One agreements together and be a comprehensive trade agreement. The Leader’s Statement that provides the roadmap for officials clearly indicates that RCEP is intended to provide significant improvements over the existing ASEAN+1 agreements, subject to specific circumstances in individual countries. The statement also pledges that RCEP will cover “trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and other issues to be identified during the course of negotiations.”

Because officials only sat down for the first round of negotiations in May 2013 and have held only 5 rounds so far, it is not yet clear how ambitious RCEP will eventually be nor how GVC-friendly the final agreement will become. If officials succeed in making the AANZFTA as the “floor” of the new agreement and build up from this position, RCEP may offer considerable benefits for supply chains in Asia. This is because AANZFTA is fairly comprehensive and includes the most significant market access commitments from the 12 parties involved for goods, services and investment as well as pledges for changes in intellectual property protections and a robust dispute settlement system. It stands in stark contrast to some of the other ASEAN+One agreements that are considerably less ambitious, even if only measured on goods commitments alone.

If AANZFTA becomes the floor, RCEP for goods could be quite helpful in encouraging supply chains across the 16 member countries. Although it is highly

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34 Officially, the target deadline for the conclusion of RCEP is end 2015.
35 And not in all members as of September 2014.
unlikely that tariffs will drop to zero across the board at the end of a relatively short implementation period like the TPP, tariff reductions could still be important. Because the Dialogue Partners do not have particularly good links to one another, the potential exists for new market access for many firms.

One of the best aspects of the ASEAN agreements has been a liberal ROO regime—the formula is usually quite simple, clean and can be used at relatively low levels of cumulation. If this translates to RCEP, it will be enormously helpful in spurring firms across all the members to plug into value chains.

ASEAN agreements have not featured much in the way of trade facilitation measures, so there is ample scope for improvement in RCEP. Even ASEAN itself has struggled to implement its own features like the ASEAN single window. Many ASEAN members have yet to install domestic-level single windows. The ASEAN-wide project is unlikely to be completed on schedule at the end of 2015 when the ASEAN Economic Community (AEC) is due to come into force.

Services and investment commitments in ASEAN+One agreements have been shallow to woeful to non-existent. Even the pledges made in AANZFTA have been relatively weak. Again, this suggests there is ample scope for improvement in a key area for GVCs going forward in RCEP negotiations. Services are using the positive list approach. It is not automatic that a positive list will result in less market opening, but countries will need to take care to be as liberalizing as possible in scheduling their reservations, otherwise, RCEP will not be as GVC-friendly as it might otherwise have been.

Conclusions

Because the chains are longer and more complex than ever, it increasingly matters a great deal what parties do elsewhere. Whatever objectives you have in a PTA can be undermined if a country further up or down the chain makes changes that cause the competitiveness of the entire chain to shift. Even if your section of the production chain is suddenly much more efficient, the chain as a whole may have become so uncompetitive as to cease production entirely. The hard-won changes in the PTA will not matter.

This suggests that pressures for larger and larger PTAs will continue to grow. The TPP and the RCEP have the potential to be quite helpful to GVCs.

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37 The Single Window is a concept that allows a trader to input data only once into the system. From there, all government agencies (like customs, security, health, agriculture, quarantine, etc.) that might need information are able to extract the relevant materials.

However, ultimately, if supply chains continue to proliferate, firms are likely to find themselves facing new barriers in the future. These barriers may drive them back to the multilateral system to sort out what will have become a very confusing, overlapping system of agreements with different provisions for different constellations of members.