A New Foundation for Asia-Pacific Growth in the Twenty-First Century

The Trans-Pacific Partnership Agreement

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ABOUT ITS GLOBAL

ITS Global is a consultancy that specialises in public policy in the Asia Pacific region. Its expertise encompasses international trade and economics, direct foreign investment, environment and sustainability, international aid and economic development, and corporate social responsibility and management of strategic risks.

ITS Global
Level 1, 34 Queen Street,
Melbourne VIC 3000
AUSTRALIA

Tel: (61) 3 9620 3400
Fax: (61) 3 9614 8322
www.itsglobal.net

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INTRODUCTION

The Trans Pacific Partnership Agreement (TPP) is a modern trade agreement among 12 Asian Pacific economies, including two of the world’s biggest economies, the US and Japan. It will lay the foundation for building in the Asia-Pacific the biggest, most dynamic, open market in the world. This will spur global growth for several decades.

This report examines the drivers of the agreement and their implications for boosting economic growth.

At the time of release, there is uncertainty about whether the agreement can be finalized in time to secure the assent of the US Congress in 2016, a Presidential election year.

If that timeline is missed, ITS Global’s assessment is that it will be enacted in 2017 because of its fundamental importance to the negotiating parties.
EXECUTIVE SUMMARY

Is trade losing its gloss? The World Trade Organization is reporting that international trade flows are no longer leading signals of growth. For two decades rises and falls in global trade foreshadowed rises and falls in growth. The Global Financial Crisis interrupted this pattern. While growth in the US is recovering, the other engines of growth are either stalled – the EU and Japan – or spluttering – China.

Investment flows seem better barometers of growth today. Globalization, the global economic phenomenon of the nineties, is the norm, not the change agent – and is now so commonplace the term is rarely used. Global business today is driven by decisions about where to invest, not where to trade. OECD analysis show returns to businesses from offshore arms are emerging as the new drivers of growth.

If investment is the new driver is the World Trade Organization redundant? No, its legal architecture is still the foundation which guides how wealth is most effectively generated by trade. Its relevance is threatened by its unwieldy and dysfunctional decision-making process. Most of its 160 members have high trade barriers and low productivity but have equal say with the one-third of members that generate 80 percent of world trade. The new drivers of global growth – investment and expanding global services markets – are not WTO priorities.

In the manner in which vacuums are quickly filled, new global architecture which recognizes these new drivers of growth is emerging. Leading the pack is the Trans-Pacific Partnership (TPP) Agreement. Adopted by the Obama Administration to recharge US interest and engagement in steady economic growth in Asia/Pacific, it looked very much like a US and smaller trading partner friends group, until Japan joined. The TPP now effectively hosts a US-Japan Free Trade Agreement.

This was a game changer. Suddenly TPP countries accounted for 40 percent of world trade. A new Chinese Administration, fully aware its economic growth machine was starting to misfire, indicated interest in joining. Its predecessor saw the TPP concept as an economic threat.

US big business likes the TPP concept. The talk in the TPP is their talk: liberalising investment, strengthening intellectual property rights, internationalizing markets for services, boosting competitiveness in national economies and guiding state-owned enterprises towards the market and away from the state.

Nor is it an accident that the participants in the TPP process are Asia-Pacific economies. This is the region that has driven global economic growth since the 1970s. The region embraced global trade, pushed reform of global trade rules and establishment of the WTO; it developed the integrated global supply chains that drove global trade for two decades.

These economies recognize the need for new global architecture to foster investment and build open markets for services. ASEAN economies give lip service to this, but have been unable to deliver; agreements to liberalize investments and services have been negotiated, but few commitments were made. An ASEAN target was to create an ASEAN Economic Community in 2015. This been pushed out into the future. The ASEAN economies that recognize the need to act are participating in the TPP negotiations.
The TPP agreement has, however, become the latest subject of anti-free trade campaigning in North America. The same forces that excoriated NAFTA and stopped the WTO at Seattle have reconvened, strengthened and campaigned against TPP. To date they have failed to foster significant Congressional opposition, but their associates have mounted similar campaigns in Australia, Canada, New Zealand and Malaysia.

They attack free trade, but are realistic enough to appreciate they cannot overturn these tools which promote growth. So, instead, their tactic is to make trade agreements Christmas trees on which they can hang their own anti-growth baubles.

Health activists want rules curbing tobacco, sugar products, and alcohol incorporated in the agreement. Australian activists even propose that trade agreements should be made subordinate to health policy -- including a dysfunctional and ineffective anti-tobacco agreement negotiated under the World Health Organization. Anti-intellectual property activists want freedom to poach electronic products. Education unions want promotion of private sector education curbed. Environmentalists want compliance with international environmental agreements tagged into the trade agreements.

Most of these entreaties have been rebuffed. In all areas of concern there are already national and international measures that allow national advancement of these interests. So far governments have rebuffed entreaties to make them operational elements of trade agreements. It is vital they do. Much more is at stake.

The negotiation of the TPP Agreement has awakened interest in the rest of the Asia-Pacific region in a trade agreement that will encompass the 21 members of the Asia Pacific Economic Cooperation organization (APEC). In part this has been generated by China, anxious about not being part of these new, powerful tools to expand economic growth in the region.

The idea of such an FTA has been bandied around in APEC for several years. The advent of the TPP agreement has reignited interest. The US and China are guiding a process in APEC to review the concept of such an FTA. It is to conclude at the end of 2016.

Whichever way this develops, the trend is clear. The planning for an expansion of or successor to TPP is underway. Expanding the TPP model across APEC economies could lay out a multi-decade period of economic growth in the Asia-Pacific region. With 60 percent of global GDP, it will be the driver of global growth for the 21st century.
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1. The importance of the TPP

The Obama Administration baulked at calling the TPP a ‘free trade agreement’ when the idea was first proposed. This was initially to assuage the anti-free trade sentiment of Democratic Party interest groups (the unions and anti-market activists) in the Congress and in civil society.

The Administration is now active in promoting its free market virtues since a majority of interests to support the agreement have been mustered in Congress.

The debate over the TPP in the US is the old debate between those who want to remove barriers to commerce across national markets and those who want to see private interests protected and increased government control of commercial activity.

The debate is futile in one sense. The battle was lost by protectionists in the 1950s and 60s when tariffs were cut using the rules of the General Agreement on Tariffs and Trade (GATT). Most industrialized economies opened their markets and generated economic growth. This helped rebuild Europe and reduce poverty there. This also sparked growth in East Asian economies as they emerged from the ravages of war and colonial rule.

The next wave of reform was in the late 1980s and early 1990s. This was the economic expansion of East Asian economies and a number of Central and South American economies. New international legal infrastructure was created with the World Trade Organization (WTO). It expanded the terms of the GATT and negotiated new agreements to liberalize trade in services and strengthen protection of intellectual property rights.

The new agreements removed restrictions on trade in clothing and textiles and laid down frameworks to open markets for agricultural trade and foster investment and trade in services.

Very significant global supply chains across the Asia-Pacific region have developed. They produce manufactured products and electronic products in particular and have driven global trade growth. All rely on greater freedom to invest and trade in goods and services, and protection of the intellectual property rights central to electronic products. Today, the major Asian economies have also come to realize that domestic economic reform is essential if growth is to be recharged (Japan) or sustained (Korea) and built on domestic consumption rather than demand in foreign markets (China). All recognize that freer trade is vital to advance domestic economic reform.

Figure 1. Global trade growth (%) by region

![Graph showing global trade growth (%) by region]
The agreements managed by the World Trade Organization (WTO) create the architecture and lay down the basic rules and principles which guide international trade in goods. The substantial majority of regional and bilateral FTAs are based on that policy architecture. That includes the European Union (EU), the North American Free Trade Agreement (NAFTA) and the ASEAN (Association of Southeast Asian Nations) regional agreements. All recognize the importance of the wider strategy today of liberalizing services and investment for sustaining and increasing economic growth. For good reasons, the WTO remains the global free trade police force. The WTO agreements are also the most significant instruments of global international law. Regrettably, a large number of the 160 members of the WTO have not fully grasped the opportunity for growth the WTO rules offer. These are the economies that have declined to use WTO rules to liberalize trade in services and set rules to liberalize investment. In today’s globalized economy, these measures are as important as removing tariffs on imported goods.

In the last thirty years, the leading drivers of growth in global trade have been Asian economies (Figure 1). They embraced the rules and principles of the multilateral trading system. Japan, Korea and Taiwan and then China charged economic growth in Asia and the world by expanding trade, particularly in manufactures of electronics and information and communications technology (ICT) (Figure 2). It is now time to move on. The new drivers of growth are service industries and investment to establish new businesses in foreign markets. With tariffs all but removed, businesses can manufacture in foreign markets instead of exporting from their own. The home economy still wins the economic benefits in the form of profits directed to the home economy.

The TPP will be an important vehicle to facilitate that purpose among parties. Most members already anticipate its expansion to include other economies in the Asian Pacific region, particularly the members of the Asian Pacific Economic Cooperation (APEC) group. A number of them, including South Korea and Taiwan, have already registered interest.

So has China; although its formal focus is on the concept of a Free Trade Area of the Asia Pacific (FTAAP) that will eventually comprise all APEC members, as well as the countries that will be part of the Regional Comprehensive Economic Partnership (RCEP)— an ASEAN-driven Asia Pacific trade initiative which is less ambitious in scope than the TPP.

In the same way East Asian economies were the drivers of global trade and economic growth in the global economy in the last three decades, the TPP and its evolution can continue to be the driver of global growth in the next half century.
2. The new drivers of growth in FTAs

Business has enjoyed the gains to growth from the removal of tariffs; it has also become obvious to business that opening markets to more foreign investment could deliver similar gains. This became practice among OECD economies. A ham-fisted attempt was made in the OECD to craft an international agreement to do this, but governments backed off following pressure from anti-growth NGOs alarmed at the further institutionalization of free trade in the WTO.

Industrialized economies went ahead and unilaterally reduced investment barriers. Regional Agreements such as the Maastricht Treaty and NAFTA embedded freedom to invest in regulations. Enlightened advanced economies also embraced foreign investment. The benefits of foreign investment also stimulated thinking about removing barriers to trade in services. In most advanced economies, the services sector generates around 80 percent of GDP.

These new drivers of growth were also embedded in the expanded trade agreements of what became the World Trade Organization. A framework to liberalize services in the pattern of reducing barriers to trade in goods was established. It would have been logical to include investment but finance ministries were not interested and nor were developing countries.

An agreement to strengthen intellectual property rights was also adopted. Important advances in patents, copyright, trademarks and labelling arising from new developments in electronic and pharmaceutical industries had not been catered for in the World Intellectual Property Organization. A fresh agreement to recognize these advances was also negotiated in the WTO.

There was belated recognition in the WTO that excluding foreign investment was a mistake. It was included in the mandate for the Doha Round of WTO negotiations which started in 2001. An early portend of the malaise which is still crippling the WTO was the decision to drop investment from the negotiating mandate. Too many developing countries did not want it. Yet at the same time, economies keen to open markets started to negotiate bilateral and regional free trade agreements which included liberalization of investment.

The business logic was compelling. Once trade barriers were reduced, whether to invest or trade was now simply a business decision. (Perhaps more accurately in the case of a number of economies, it can now also be a tax decision).

Today every substantial free trade agreement carries provisions to remove investment barriers. These are usually agreements where at least one party is an advanced economy. ASEAN has a fully developed investment agreement but few parties have made commitments. In ASEAN’s case, the intent is right but the will is lacking.

3. Foreign investment’s new role

In the two decades leading up to the Global Financial Crisis (GFC), international trade led global growth. Almost invariably when global trade dropped, GDP would drop afterward and when it rose, GDP rose afterward, generally at twice the rate of rise and fall in trade. Since the GFC, this has stopped.

There is speculation now that trade is less important. It may be too soon to call this. The direction in which the global economy will move is still uncertain and the economic malaise in Europe seems set to linger.
What is clear however is that investment is outstripping trade and is an increasingly important contributor to economic growth in the economies where outward investment is strong.

With the reduction of global tariffs in the major economies (except in those with traditionally over-regulated agricultural sectors) it is logical that investment into foreign markets would rise. Analysis by the OECD illustrates this clearly. Research by the OECD and US think-tanks, such as the Petersen Institute in Washington DC, shows contrary to ‘street wisdom’, that growth in these investments contributes directly to growth in home economies.

Contrary to the case made repeatedly by organized labor that investing in foreign markets means exports of jobs, this research shows because of the earnings in the foreign market, value to the home enterprise rises, salaries rise, there is no job loss and research and development increases. This explains why investment by enterprises in foreign markets in increasing rapidly.

4. The growing role of intellectual property

The popular story about who earns the lion’s share of value from the sale of iPhones and iPods exported from China shows the rising importance of intellectual property. It is a key part of the manufacturing process.

The product is exported from China but the high value is from product manufactured elsewhere where a key cost is fee for the use of the intellectual property. The value created in China is very small, distorting the value to the Chinese economy of the export.

In today’s world the value of intellectual property – a patent, a trademark or copyright, for example – and protection of that value is a key asset in today’s globalized economy.

Economies which protect those properties will be, along with those that regulate removal of services barriers and restrictions to investment, the most prosperous economies.

This is the world of the Trans Pacific Partnership.

Figure 3. IPhone manufacturing costs

5. Why is the TPP slow to complete?

There are two reasons. The first is the complicated process of negotiation. There are 12 participants. Six already had FTAs with the US and it mandated the tariff schedules in the bilateral agreements would not be renegotiated.

So negotiations focussed on other areas such as investment, intellectual property and dealing with state-owned enterprises.

This was the case until Japan joined the negotiations. This resulted in reopening some agreements on tariff lines, particularly in controversial areas such as automobiles and agricultural products.

Today, securing agreement on this is what is holding up the agreement. US and Japan agreed to some changes in tariffs and application of rules origin in trade in automobiles which generated strong opposition from Canada (heading into an election) and Mexico.

If an agreement is reached, deals among the US, Canada and New Zealand about access to the markets of others, particularly access to the US dairy market will be implemented. If it is not, they lapse.

The second reason completion of the TPP is slow is that it took the Administration considerable time to secure the agreement of Congress to a ‘fast track’ process of adoption of the Agreement. Under the US Constitution, Congress adheres to international agreements, not the Administration. Securing the agreement of Congress to any complicated international agreement is always difficult. There had been a ‘fast track’ process in the past. Its essential point was that Congress accepted or rejected the treaty, but did not amend it. But it had lapsed.

President Obama succeeded in getting Congress to agree a new fast track process. But he could not do that until the shape of the Agreement was well advanced. Only recently has the Congress adopted a ‘fast track’ process where a trade Agreement is voted on in its entirety.

There is now something of a race against time. It is accepted wisdom in the Administration and the Congress that if passage of the TPP Agreement is left too late (i.e. too close to the next Congressional and Presidential election) it will not be adopted by the Congress and will have to lie over until the next President and Congress are elected.

6. Attacks on the TPP

There have been strong attacks on the TPP, principally by activists in the US, but they have been echoed in some other TPP economies, particularly Canada, Australia and New Zealand.

There have been opponents of free trade agreements since the General Agreement on Tariffs and Trade was adopted in 1947. Initially they were mostly from trade unions. However in the late 1980s, after the Berlin Wall came down and threat of communism dissipated, globalization became the enemy of anti-establishment activists.

They became more active after the creation of the World Trade Organization and vowed to bring it to its knees or conscript it as a vehicle to advance their own interests. There was an acute calculation here. At around the same time several environmental agreements stalled or were
significantly watered down. Global taste for materializing the leading interest of activist groups into international law faded.

New tactics were adopted. Activists sought to turn the trade agreements into vehicles to advance their interests. Environment groups sought to set compliance with environmental standards as a condition for trade. Anti-intellectual property activists sought to dilute IP law and use the WTO agreements for this purpose. Public health activists sought to subordinate the rules of the WTO to rules set by the World Health Organization, for example to the non-binding World Health Organization treaty to restrict us of tobacco, sugar and alcohol.

All this action deliberately ignored the fact that WTO agreements provided for exemptions to their rules for matters concerning animal and plant health and safety. On the environmental front the real challenge for activists was that there was no support in the UN for the sort of environmental treaties they wanted to see in place.

The strategy was clear. Treat the trade agreements as Christmas trees on which to hang the anti-trade baubles of the activist groups.

7. The challenge to the global trade community

The TPP is a new instrument. While classical disputes continue over trade in agriculture, the prime movers in building growth through liberalization today are those that remove barriers to trade in services and barriers to investment; and those measures that protect the integrity of the intellectual property rights regime.

These areas are the prime targets for the activists. These are unsurprisingly the areas where fresh foundations can be laid to move the global economy into a new phase of prolonged economic growth.

The TPP is a fresh global platform from which to do this. Its participating economies are economies where its policy-makers know that growth in the future rests on opening services markets, removing barriers to investment and protecting the intellectual property regime.

It may not matter if trade in goods is no longer the leading indicator of the directions of growth in GDP. Today a new indicator may be the returns to business from arms operating in other economies. Another will be returns to industries from intellectual property rights.

The framework set in the TPP will generate growth in the Asia-Pacific region for those economies ready to move to it. Advanced economies in the Asia-Pacific region have done so. It is the developing economies in the region, including China, who have not done so which have much to gain.

Beijing is showing signs of interest. It is clearly uncomfortable that it is not participating in the TPP negotiations. The US Administration has stated it is not ready. Given the rudimentary condition of China’s internal financial arrangements, that seems defensible.

China clearly wants to be part of the bigger economic play and is seeking to advance APEC to that point. The idea of an FTA among all APEC economies has been tossed around in informal circles in APEC for around a decade. It is under review again, with direct participation jointly by China and the US. This is a major indicator, one that has been largely overlooked by business and the media. Is it ready for this?
The record is positive. After China acceded to the WTO in 2001, it assumed the role as model citizen. It did not play games with the dispute system, it removed barriers, and it challenged in the disputes settlement processes and used the rules to contest the policies of other members.

China is readying for the new phase of economic growth driven by expansion of foreign investment, expansion of trade in the services sector and adherence to property rights and adherence to intellectual property rules.

8. The challenge to Asia-Pacific economies

In the same way that 40 years ago the GATT, and 20 years ago the Uruguay Round agreements created growth pathways for the emerging Asian and Latin American economies, the TPP Agreement, whenever it is completed, puts the same opportunity in front of those economies participating in that process.

Those who take it will benefit. All they need to do is commit to open services markets, remove barriers to investment and implement sound intellectual property law.

Everything is pointing to the development of a successor or extension of the TPP which brings all 21 members of APEC, including in particular China, into that orbit. The result will be the biggest free trade area in the world, encompassing 60 percent of global GDP.

The challenge for regional economies is not to work out when to aim to associate with these systems, but to start now. The economies tuned to operate in the economic environment which is emerging will be those who benefit from it first.
Notes

1 The Other APEC member economies are China, Hong Kong, Indonesia, Papua New Guinea, Philippines, Thailand, Russia, and Taiwan.
2 The RCEP is an FTA under negotiation between the 10 ASEAN member countries and Australia, NZ, Korea, China, Japan and India.
3 This was the Agreement on Trade Related Aspects of Intellectual Property (TRIPS)
4 Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore, USA, Vietnam