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Trans-Pacific Partnership (TPP) Agreement

Increased Pressure on European Trade Policy

Hanns Günther Hilpert

After five years of intense negotiations, trade ministers of twelve Pacific Rim countries, including the United States, Canada, and Japan, have reached agreement on a comprehensive Trans-Pacific Partnership (TPP). Whether and when this agreement will come into effect depends above all on the ratification process in the US Congress. If ratified, the TPP will create the largest free trade zone worldwide. It will not only eliminate virtually all tariffs on trade and open up domestic markets extensively in the areas of agriculture and services, but also set binding minimum standards for trade and investment. The biggest “losers” under the TPP are the countries that are not part of the negotiations – especially two of the world’s economic heavyweights: the EU and China. They are finding themselves increasingly on the defensive in trade policy.

The nucleus of the TPP was formed by the countries of Brunei, Chile, New Zealand, and Singapore (P4), which signed a multilateral free trade agreement in 2005. After the United States, Australia, and Peru expressed interest in joining them in negotiations, followed by Malaysia, Vietnam (2010), Mexico, Canada (2011), and Japan (2012), the TPP became the new prime focus of trade policy development in Asia. The agreement would represent 11.1% of the world’s population, 36.2% of global GDP, and 26.2% of global trade (2014). For the participating countries, the prospect of a large trans-Pacific free trade zone that would encompass the United States looked appealing and promising for a number of reasons. First, the TPP guarantees permanent preferential access to the major im-

port markets of the Asia-Pacific. Second, the increased foreign trade and intensified international division of labor that stands to result from such an agreement will bring all of the signatories more income, employment, and growth. Third, the tariff reductions and common standards for rules of origin, customs processing, investments, and digital networking will allow more efficient cross-border production and supply chains, which in turn will reduce costs and improve competitiveness. Fourth, the integration of developing and newly industrialized countries into the TPP will demonstrate their capacity to connect the industrialized countries’ markets, and will also give these countries a decisive competitive edge when seeking to attract foreign investment. Fifth, the agreement sets comprehensive binding

trade standards that are designed to deepen economic integration of the signatory nations and further the development of the international trade system in general. Last but not least, in addition to the expected trade policy advantages there is also a geopolitical argument: the TPP will anchor the United States within the Asia-Pacific region and act as a trade and economic policy foundation for US security alliances in Asia. The TPP demonstrates that the United States will not allow itself to be pushed out of the region by China's ascent.

The most important trade agreement since conclusion of the Uruguay round

The TPP agreement can be regarded as historic in its scope. First, the 12 countries participating in the TPP will comprise the largest free trade zone in the world. This is particularly significant because of the bilateral trade liberalization it will entail between economic heavyweights United States and Japan. Second, the agreement provides for sweeping opening of markets, trade liberalization measures, and standardizations. Third, the range of topics covered in the 30 chapters of negotiations is extremely broad. These include plans for a deep integration of markets.

Under the TPP, tariffs and trade barriers on goods trade between the participating countries will be largely eliminated. Canada and the United States, however, have introduced longer transitional periods and binding regional value-content requirements for the automotive and apparel sectors. Thus, the exemption from tariffs on motor vehicles will only apply if at least 45% of value added is generated in TPP member states. This percentage was the subject of intense debate up to the conclusion of the agreement, particularly because the North American Free Trade Agreement (NAFTA) included a 62.5% regional value content requirement. Discussion over the liberalization of agricultural imports was even more heated. Japan ultimately accepted a substantial opening of its agricultural markets.

Japan will substantially cut import tariffs on beef (from 38.5 to 9%) and pork (from 482 to 50 Yen/kg). Canada succeeded in defending its protectionist agricultural system for dairy and poultry products, but made initial import rate concessions to allow for imports representing 3.25% of Canada's current annual dairy production and 2.1% for chicken. The United States agreed to open its market to dairy and sugar imports, and has virtually eliminated tariffs on wood, wine, fruits and vegetables, sheep meat, fish, and seafood.

As noted above, the TPP goes much further than classic trade liberalization. It also includes legally binding "behind-the-border" measures: (1) In the cross-border trade in services, quantitative restrictions, requirements of local presence, and discriminatory regulations and government procurement procedures are inadmissible under the agreement. These basic principles are applied in more precise detail in the TPP's chapters on telecommunications, financial services, and e-commerce. A critical point from a European perspective is that centralized data storage outside a country's sovereign territory can no longer be forbidden. (2) To prevent discrimination in trade, the TPP includes binding transparency requirements in areas like customs processing, health, and plant protection (sanitary and phytosanitary measures, SPS), technical barriers to trade (TBT), and trade policy protection measures. (3) The usual rules requiring non-discriminatory policies and protections apply to investments. In the case of expropriation and discrimination, there is the option of investor-state dispute settlement proceedings. Procedural guarantees and opt-out clauses (regarding application of rules to the tobacco industry) are designed to prevent abusive and disproportionate legal suits. (4) To protect intellectual property rights, the agreement imposes formal legal standards and the duty to provide strong enforcement of these rules in standard business practice. For patent protection on controversial biological pharmaceutical products, there is a minimum of five years of data protection, far less than

the 12 years that the US pharmaceutical industry had been campaigning for. Geographical designations of origin can only be protected within the framework of trademark protection, which is inadequate from a European perspective. (5) For government procurement, the TPP signatories will each provide a positive list of state institutions and companies that agree to TPP-wide government procurement procedures. (6) With regard to state-owned enterprises, the signatory states agree to adhere to the principles of making commercial purchases based on commercial considerations and the principles of non-discrimination, impartial oversight, non-subsidization, and transparency. (7) In the chapters of the TPP on labor, environment, and development, the signatories pledge to uphold the ILO labor standards and the relevant international environmental agreements and to adhere to common principles of economic development. These obligations contained in the agreement have a number of aims: that Vietnam recognize trade union rights, that Malaysia reduce human trafficking, that Japan eliminate harmful and unsustainable fisheries subsidies, and that all of the member states make concerted efforts to stop the trade in endangered species. (8) In addition to the aforementioned chapters on labor, environment, and development, other negotiation chapters stipulate the duties of implementation and ongoing cooperation in committees that still remain to be formed, namely: Human Capacity Building, Competition, Small and Medium-Sized Enterprises, Regulatory Consistency, Transparency and Anti-Corruption, as well as Administrative and Institutional Provisions. (9) A state-state dispute settlement mechanism may be invoked in all parts of the agreement including the areas of labor and the environment. Trade policy sanctions may be imposed if states fail to comply with binding rulings of the dispute settlement body.

Ratification with a question mark

The agreement will enter into force as soon as it has been ratified by all of the member states, or after two years if at least six countries representing 85% of the bloc's GDP agree on its implementation. This means that approval by Japan and the United States – the two largest economies – will be crucial. While Japan's parliament is expected to approve the trade agreement, ratification by the United States is still in question. After all, the US Trade Promotion Authority (TPA), a temporary power granted to the President, passed Congress in June with just a narrow majority and subject to 150 negotiating objectives. The TPA empowers the president to negotiate trade accords that Congress can only approve or disapprove in full. This condition was necessary to ultimately achieve agreement on the TPP since US trade partners would not have been prepared to make the concessions they did if there were a threat of further negotiations in Congress. Now, however, the outcomes of the negotiations on the TPP are being subjected to substantial critical scrutiny from congressional representatives, lobby groups, and the media.

Even before the full text of the TPP was released, numerous leading US congressional representatives and presidential candidates were skeptical, disappointed, or even openly opposed to the agreement. Hillary Clinton, who helped to initiate the TPP during her tenure as Secretary of State, has now moved to the side of the skeptics in her bid for the Democratic presidential nomination. On the other hand, important industrial and agricultural associations support the agreement. At the present point in time, it is uncertain how congress will vote on the issue. One thing is certain, however: Given the widespread opposition in the Democratic Party, the TPP has little chance without strong Republican support. Furthermore, the timing for the rest of the ratification process is extremely unfavorable. A vote can take place only 90 days after the White House has sent official notice of intent to Congress to sign the agreement.

Congress will then need additional time to introduce the implementing bill in the House and Senate for approval, meaning that a vote cannot reasonably be expected before March 2016. By then, the crucial phase of voting in the presidential primaries will be underway. That will make it even more difficult for proponents to marshal the necessary political support to get the controversial agreement passed.

Europe and China on the defensive

Although it is difficult to predict how the rest of the ratification process will unfold, the likelihood of a trans-Pacific free trade agreement has increased significantly. The potential consequences of this agreement for the trade relations and trade policies of non-participating countries – and for the multilateral trade system as a whole – are vast.

The market openings, liberalizations, and standardizations set out in the TPP agreement do not apply to the countries that are not part of the negotiations. They will suffer substantial losses due to discriminatory trade diversion. These non-participating countries will come under pressure to either join the TPP free trade zone or to accept the new trade regulations unconditionally. This in turn could undermine the coherence and universality of the multilateral trade system as a whole. In Asia, the TPP would then probably develop an even stronger appeal above and beyond its already existing economic advantages. Korea, Thailand, Taiwan, the Philippines, and Indonesia have already indicated interest in joining the partnership. While its strict standards would make it impossible for many Asian countries to join at the current stage, the TPP could, in the longer term, advance to become the new “gold standard” of global trade and overshadow the soft regionalism prevalent in Asia. The Association of South-east Asian Nations (ASEAN), which plans to launch a regional economic community on December 31, 2015, threatens to be split into members and non-members of the TPP. China’s accession to the TPP, on the other

hand, is now considered possible in the medium term. This is due to the expected trade losses and the risk of being excluded from the ongoing development of new trade rules. China does have a range of other foreign trade policy options, however. It could choose to pursue China-centered regional integration regimes such as the ASEAN+6-Regional Comprehensive Economic Partnership (RCEP), enhanced physical connectivity through infrastructure financing (AIIB), the maritime and terrestrial Silk Road initiative (OBOR), or intensified cooperation with the BRICS countries.

The potential consequences of the TPP agreement could be significant for European trade, especially for exports to Japan. Furthermore, Brussels has had the disillusioning experience that multilateral trade regulations effectively developed in negotiations elsewhere often turn out to be disadvantageous for the EU. For the Obama administration, the agreement with the Pacific states is undoubtedly the more important one for economic and geostrategic reasons. It should also be kept in mind that if the TPP does become a reality, this will substantially increase the costs of a failed free trade agreement between Canada, the United States, and Japan. What is at stake is not just compensation for the loss of market shares due to the TPP but also non-discriminatory market access in the Pacific Rim. A Europe that fails to create a trans-Atlantic economic partnership while a similar partnership is taking shape in the Pacific will also be a less appealing partner for other countries. For Europe, this means that it has become all the more important to bring negotiations with the United States and Japan to a speedy conclusion. But even more important will be the translation of the large, trans-regional agreement into a global framework that is in conformity with the rules of the World Trade Organization (WTO). Negotiations with China over a bilateral agreement should be initiated before the People’s Republic submits an application to join the TPP.

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