

# Mega-FTAs and the Trade-Security Nexus: The Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP)

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# Asia Pacific

## I S S U E S

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*Papers in the AsiaPacific Issues series feature topics of broad interest and significant impact relevant to current and emerging policy debates. The views expressed are those of the author and not necessarily those of the Center.*

**SUMMARY** The rise of a multiplicity of diverse bilateral free trade agreements (FTAs) has led countries to pursue mega-FTAs to manage the growing complexity of global trade arrangements. The US and China are promoting rival accords: the Trans-Pacific Partnership (TPP), which would encompass 800 million people and almost 40 percent of global GDP, is a centerpiece of the Obama Asia Pacific strategy. The Regional Comprehensive Economic Partnership (RCEP) would account for 30 percent of global GDP, with a population of over three billion people, creating the largest FTA in the world. TPP advocates assert that it will strengthen the US' strategic role in the region, in part by countering China's membership in the RCEP. These claims, made in response to growing skepticism in the United States about the value of liberalized trade, overemphasize the TPP's strategic value. At the same time, projecting the economic impact of the TPP is thorny, given the deal's scope and the diversity of countries involved.

Global trade has rapidly expanded since the end of World War II, leading to greater efficiency and growth in the global economy. For decades, first under the auspices of the General Agreement on Tariffs and Trade (GATT) and then its successor organization the World Trade Organization (WTO), countries successfully negotiated the reduction of both tariffs and nontariff barriers every few years, convening in “rounds” named by location. But in December 2015, after 14 years of fruitless negotiations, WTO members terminated the Doha Round.

Even before the demise of the Doha Round, growing frustration with the slow pace of multilateral negotiations led many countries to seek alternative ways to liberalize international trade, including bilateral free trade agreements (FTAs), minilateral regional accords, sectoral accords, and more recently, so-called mega-FTAs that link countries across regions.<sup>1</sup> Two prominent mega-FTAs involve countries in the Asia Pacific—the recently concluded but yet-to-be-ratified Trans-Pacific Partnership (TPP)—and the proposed Regional Comprehensive Economic Partnership (RCEP).

Proponents of each accord have high expectations and are making bold claims. Advocates of the TPP assert that it will strengthen the US’ strategic role in the region, in part by countering China’s membership in the RCEP, claims made in response to growing skepticism in the United States about the value of liberalized trade. Advocates of the RCEP argue that it can be a stepping-stone to the broader and more liberal TPP, rather than rival mega-FTAs, with both eventually subsumed into a Free Trade Area of the Asia-Pacific (FTAAP) under the auspices of Asia-Pacific Economic Cooperation (APEC).

Before focusing on these claims, it is useful to examine the institutional context within which the agreements are being negotiated and the nature of both agreements.

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### **Moving Away from Multilateralism**

The Doha Round negotiations began in 2001, with the goal of further broad-scale trade liberalization. But as the Doha Round dragged on, countries

continued to pursue alternative approaches to trade liberalization.

First, on a sectoral basis, countries negotiated specific multilateral liberalization including the Information Technology Agreement in 1997, the Basic Telecom Agreement in 1998, and the Financial Service Agreement in 1999.

Second, on a regional basis, countries have continued to pursue trade liberalization integration, including the European Union (EU); the US-Canada Free Trade Agreement (NAFTA) in 1995; the Association of Southeast Asian Nations (ASEAN) Free Trade Agreement in 1992, which evolved into the ASEAN Economic Community in 2015.

Third, since the late 1990s, countries have negotiated a flurry of bilateral FTAs. While there were only 47 FTAs in 1994, the number had increased to 262 by the end of 2015.<sup>2</sup> Major economic powers such as the United States, the EU, China, and Japan and medium-sized economies such as South Korea, Chile, Mexico, and Singapore have all negotiated an array of bilateral FTAs—often with strategic and political objectives in mind. The result of this rapid expansion has been labeled “spaghetti” or a “noodle bowl.”

All three approaches can be problematic. Sectoral agreements tend to undermine the coalition for free trade by focusing on “winners” from trade agreements.<sup>3</sup> By simply liberalizing in one sector, negotiators cannot engage in cross-sectoral trade-offs. This makes it difficult to move forward on broad-scale trade negotiations in forums such as the WTO because “losers” or uncompetitive industries block negotiations, while globally successful industries lose interest since sectoral arrangements meet their goals.

Regional approaches create their own sets of rules and procedures, and often have regional content requirements that impede global sourcing efforts. The recent conflicts between the United States and the EU over the latter’s regulation of Google and other American companies demonstrate the potential problems of creating differing regulatory regimes.

Bilateral FTAs, with their varying provisions, can also lead to significant discrimination and impede trade. Indeed, this growing complexity provided

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one of the key motives for countries to turn to mega-FTAs—multilateral FTAs that involve a large number of participants across vast distances. The goal of these agreements has been to rationalize the multiplicity of bilateral FTAs. Put differently, as some analysts have suggested, the spaghetti might be made into lasagna.<sup>4</sup>

With the proliferation of both bilateral and regional accords in the Asia Pacific region, it is no surprise that these countries have been among the first to embark on mega-FTA negotiations. The logic is that mega-FTAs with 12 to 16 members might be more tractable in terms of negotiations than the 162-member WTO.

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### **The Trans-Pacific Partnership**

Twelve countries in Asia and the Americas negotiated the TPP trade deal, concluding in October 2015. Alongside the United States and Canada, the accord includes three Latin American countries (Chile, Mexico, and Peru), four Southeast Asian countries (Brunei, Malaysia, Singapore, and Vietnam), and three traditional US partners in the region (Australia, Japan, and New Zealand). The TPP would create a free trade area encompassing 800 million people and almost 40 percent of global GDP.<sup>5</sup>

The idea of creating a pan-Asia Pacific trade agreement, began to move forward in 2006 with enthusiastic support from the APEC Business Advisory Council. The strategy was to turn APEC from a talk shop into the FTAAP.

Yet given APEC's lack of an institutional mechanism to negotiate trade agreements, as well as its large membership of 21 economies, efforts to promote the FTAAP faced strong headwinds.<sup>6</sup> Meanwhile, the Trans-Pacific Strategic Economic Partnership Agreement, known as the P4, begun in 2002 by Chile, New Zealand, and Singapore, with Brunei joining the negotiations in 2005, began to move forward. This P4 agreement called for trade liberalization that went beyond traditional border barriers to include such elements as the regulation of intellectual property, rules of origin, and government procurement—often referred to as “behind-the-border” measures. The P4 FTA left the door open for other countries in the

region to join. In September 2008, the Bush Administration signaled its intent to become part of the so-called P4, which subsequently evolved into the TPP, as part of its own Asian engagement strategy. Soon thereafter, Australia, Peru, and Vietnam announced their intention to participate.

In November 2009, the Obama Administration affirmed that it intended to take part in TPP negotiations. After several years of prolonged negotiations, agreement was finally reached in October 2015. Yet, TPP ratification is hardly a foregone conclusion, particularly in the United States. A number of specific areas of the agreement have proven contentious, and these disputes will continue to fester as the TPP moves toward ratification.

First, with respect to intellectual property (IP) provisions, the TPP mimics current US law, fostering complaints both in the United States and abroad. Foreign TPP partners are resistant to expanding their copyright protections to the American scope, arguing that such regulations impede their sovereignty.<sup>7</sup> Some American interest groups are concerned that enacting an agreement that freezes IP laws as of the signing date will prevent US legislators from adapting laws in the future to meet the evolving needs of digital innovation and entrench controversial policies such as the Digital Millennium Copyright Act (DMCA). The DMCA, criticized for censoring online content through spurious copyright claims, has fewer mechanisms for reviewing such content before removing it than copyright laws abroad.<sup>8</sup>

With respect to pharmaceuticals, members of Congress have expressed concern that increased IP regulation will restrict access to medicine in the developing world, weakening access to inexpensive generic drugs. Biologics, a class of drugs developed to treat rheumatoid arthritis, psoriasis, Crohn's disease, and many others, have also been a source of much controversy. The pharmaceutical industry lobbied for increased protections to prevent competitors from copying and selling biosimilars without expending the same resources on clinical trials. Current US law protects such drugs for 12 years, but under fire, the United States negotiated a two-track system that protects data for either 5 or 8 years.<sup>9</sup>

*‘When it comes to Asia, one of the world’s fastest-growing regions, the rulebook is up for grabs’*

Second, currency manipulation issues have created controversy. While the TPP has no specific language around currency manipulation, there is a separate anti-manipulation declaration that lacks any specific enforcement mechanisms.<sup>10</sup>

Third, although the TPP states that state-owned enterprises cannot be favored over private entities, the complexity of ownership and structure of state-owned enterprises in Southeast Asia leaves many unanswered questions over how to enforce this clause.<sup>11</sup> For free-market proponents, the validation of foreign state-owned enterprises is against the principles the TPP supposedly espouses.<sup>12</sup>

Fourth, the TPP’s Investor-State Dispute Settlement (ISDS) clause enables foreign companies to sue national governments in binding arbitration for regulations that may diminish profitability.<sup>13</sup> This could lead to investors being compensated for governments implementing regulations designed to promote sustainability, human rights, and intellectual property. The TPP contains a “tobacco carveout” from ISDS, which excludes anti-tobacco measures from investor-state disputes, but, with the sweeping powers given to foreign companies, countries’ power to create product safety or public health laws remains unclear.<sup>14</sup>

From an aggregate economic standpoint, projecting the impact of the TPP is particularly thorny given the deal’s scope and the diversity of countries involved. According to a widely cited 2012 study, updated in 2016, swift TPP implementation will raise US real income by \$131 billion by 2030, with similar large gains in Japan.<sup>15</sup> Meanwhile, a 2016 World Bank Study using another CGE model found that the GDP impact on the United States and Australia will be negligible, with few losses for non-TPP members in the region.<sup>16</sup> These widely diverging projections show the uncertainty of the TPP’s economic outcome.

With growing opposition to trade liberalization, and to globalization more generally, the Obama Administration (and the Bush Administration before it) has pushed the importance of the TPP as balancing China, from both economic and security standpoints:

[T]he TPP means that America will write the rules of the road in the 21st century. When it comes to Asia, one of the world’s fastest-growing regions, the rulebook is up for grabs. And if we don’t pass this agreement—if America doesn’t write those rules—then countries like China will. And that would only threaten American jobs and workers and undermine American leadership around the world.<sup>17</sup>

Trade negotiations have often reflected both security and economic interests. The GATT, in particular, had important security overtones given the Cold War context. The bilateral FTAs concluded by the Bush Administration in the 2000s were often created with a clear political and security intent.<sup>18</sup>

What differs in this case is that the growing domestic opposition to trade liberalization has made selling the TPP very difficult, leading to reliance on oversold strategic claims about the US-China relationship and broader security concerns in the Pacific.<sup>19</sup> In May 2015, a letter from seven former defense secretaries and ten top military leaders to the House noted: “China is already pursuing an alternative regional free trade initiative. TPP, combined with TTIP [the Transatlantic Trade and Investment Partnership], would allow the United States and our closest allies to help shape the rules and standards for global trade.”<sup>20</sup> In concluding, the letter argued:

The stakes are clear. There are tremendous strategic benefits to TPP and TTIP, and there would be harmful strategic consequences if we fail to secure these agreements. In both Asia-Pacific and the Atlantic, our allies and partners would question our commitments, doubt our resolve, and inevitably look to other partners. America’s prestige, influence, and leadership are on the line.

Current Secretary of Defense Ashton has also emphasized this strategic theme. As he put it:

[Y]ou may not expect to hear this from a Secretary of Defense, but in terms of our rebalance in the broadest sense, passing TPP is as important to me as another aircraft carrier.<sup>21</sup>

What has been the Chinese reaction to these claims, both economic and security, about balancing against China? Although Chinese academics and commentators have claimed that the United States is pushing the TPP to contain China,<sup>22</sup> Chinese officials have been more measured in their response. For example, Foreign Ministry spokesman Lu Kang made a statement telling nations “not to politicize trade and economic issues”<sup>23</sup> and President Xi Jinping at the November 2015 APEC meeting argued that its members should “make free trade arrangements open and inclusive to the extent possible with a view to enhancing economic openness in our region and upholding the multilateral trading regime.”<sup>24</sup>

Yet with the US election season underway and with Democratic candidate Hillary Clinton and the leading Republican contenders already opposing the TPP, passage is not likely to be easy. The temptation to frame the TPP in economic and strategic balance of power terms in an effort to pass it may thus divert attention from the specifics of the agreement.

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### **Regional Comprehensive Economic Partnership**

The mega-trade agreement abbreviated as RCEP consists of 16 countries known as ASEAN+6. This grouping brings together the 10 member states of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Burma (Myanmar), the Philippines, Singapore, Thailand, and Vietnam), and six major regional economic partners (Australia, China, India, Japan, South Korea, and New Zealand). These six countries have already signed FTAs with ASEAN as a group. ASEAN, initially founded in 1967 as a regional security forum during the Cold War, gradually expanded its mission to include the promotion of region-wide trade liberalization. The ASEAN+3 grouping was created in 1996, with China, Japan, and South Korea. Australia, India, and New Zealand’s later participation eventually transformed this grouping into ASEAN+6.

Japan first proposed a free trade area covering ASEAN+6 countries. With the TPP underway, China, which initially was strongly pressing for an ASEAN+3 grouping, agreed to the ASEAN+6 approach.

Moreover, ASEAN countries not involved with TPP negotiations were also keen to make progress in trade liberalization, including Indonesia, Thailand, and the Philippines, three of the four most populous members of ASEAN.<sup>25</sup>

The creation of RCEP was formalized in November 2012. In May 2013, officials established working groups on the three issues they hoped to address: trade in goods, trade in services, and cross-border investment. In contrast to the TPP, which aims to become the “gold standard” for international trade and tolerates few carved-out exceptions for individual countries, RCEP is considerably more accommodating and focuses on traditional trade policies, rather than the comprehensive set of domestic policies and regulations being discussed in the TPP. Currently, negotiations are ongoing and 11 rounds have been completed. Although participants have set the end of 2016 as the target, this deadline seems overly ambitious given the relative lack of progress.

RCEP will create the largest free trade area in the world. While it will account for about 30 percent of global GDP, less than the TPP, it will have a combined population of over three billion people.<sup>26</sup> Studies conducted on the potential impact of RCEP on US businesses have led some researchers to argue that the effect on US exports will be limited, as US exports to RCEP countries rarely compete with products from other RCEP countries. Examples of these US products include aircraft, medical devices, and pharmaceutical products. Nevertheless, while RCEP might not be directly detrimental to US businesses, it is clear that the treaty will enhance China’s regional economic power by allowing it to greatly expand its trade influence.

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### **FTAAP, TPP, and RCEP:**

#### **Fitting the Institutional Pieces Together?**

With the United States and China continuing to push forward rival mega-FTAs, China announced an interest in rekindling the FTAAP in November 2014. At the 2014 APEC summit in Beijing, Chinese President Xi Jinping announced several projects that aim to enhance trade and cooperation within the Asia Pacific region, including the FTAAP. China’s

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proposal to revive the FTAAP, although surprising in view of its lukewarm reception when the topic was first broached a decade ago, was subsequently endorsed by APEC leaders, including President Obama. The president also argued that the United States does not intend to use the TPP as a tool of containment against China, but that the treaty, along with RCEP, will form a foundation for a region-wide deal like FTAAP.<sup>27</sup> Analysts expect that the FTAAP will likely contain higher standards than RCEP, but will probably not match the TPP's "gold standard," as China and other Asian countries do not seem ready to accept the TPP's wide-ranging stipulations.<sup>28</sup>

Can TPP, RCEP, and FTAAP fit together from an institutional architecture standpoint? Conceptually, to avoid conflict among overlapping institutions, three alternatives are possible: hierarchically ordered nested accords, horizontal division of labor, or simply institutions with independent mandates.<sup>29</sup> An example of nesting is the relationship of the WTO to regional FTAs (with the latter recognized under Article 24). Horizontal division of labor can be seen in the original relationship between the International Monetary Fund (IMF) and the World Bank, with the former focusing on short-term balance of payment lending and the latter on longer-term projects.

Suggestions that RCEP could provide a stepping-stone to the broader and more liberal TPP for some members, with both under the FTAAP umbrella, are dubious as the precedent for such an approach is not promising.<sup>30</sup> In 1994, the EU and EFTA created the European Economic Area (EEA), an umbrella organization for the EU and EFTA, allowing eastern European countries to join EFTA as a stepping-stone to EU membership.<sup>31</sup> Yet the EEA ultimately failed as prospective applicants pushed to join the EU directly. While the EEA, EFTA, and the EU continue to exist, the EU is clearly dominant, and the nesting idea has not worked well. In the case of the TPP and RCEP, while both transregional accords are likely to persist—since institutions rarely die—their incompatibility, given their sharply differing goals, is likely to prevent a happy reconciliation.

Although both are trade agreements, the TPP and RCEP differ significantly. RCEP is likely to follow

the Chinese approach of signing first and negotiating later. It is also much less focused on behind-the-border measures, which are the subject of the TPP. With most Asian countries pursuing active industrial policies, strongly binding rules that would constrain government behavior seem unlikely. While China and other participants would clearly benefit from market opening under RCEP, Chinese businesses worry that they will be negatively affected by the TPP because Chinese exports to the United States, such as electronics and textiles, tend to be in the same sector as exports from TPP countries.<sup>32</sup> The passing of a final version of the TPP has spurred RCEP negotiations. As far as the FTAAP is concerned, while the United States and China are now co-chairing a study on its benefits and prospects, at best this is a long-term goal.

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## Conclusion

With the rise of alternative trading arrangements, including sectoral, regional, and bilateral accords, countries have created a complex and often unmanageable set of accords that may actually undermine rather than facilitate open trade. Each agreement has its own rules and procedures, and the various exceptions and restrictions often make it difficult for businesses to manage their global supply chains. While this is undoubtedly a problem for large firms, it is clearly a nightmare for smaller companies. In this context, the move to create so-called mega-FTAs such as the TPP and RCEP can be seen in a positive light.

However, negotiation and, in the case of the TPP, ratification are by no means a foregone conclusion. The rise of anti-globalization sentiment in the United States has meant that the Obama Administration (and the Bush Administration before it) has overemphasized the security benefits of these accords. Thus, the efforts to push the TPP through, and the likely efforts over the next year, will carry a strong tone of economic and security balancing against China. While China's reaction has been relatively restrained, these arguments often strain credibility and fail to emphasize the TPP's own merits.

In this context, given the creation of potentially two rival mega-FTAs in the Asia Pacific region, the

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RCEP led by China and the TPP led by the United States, reconciliation of the two accords is being discussed. This has led to a renewal of interest in the FTAAP, which might serve as an umbrella arrangement under APEC's auspices. Yet for the moment, the FTAAP seems a distant goal, and the logic of nesting quite disparate accords is not promising.

Still, if both mega-FTAs come into effect, they will influence the economic and political dynamics within the Asia-Pacific region. Given that the United States is currently pursuing a TTIP with the EU, a third major mega-FTA in the global economy, competition over who will set the rules of trade for the twenty-first century will continue to accelerate.

## Notes

<sup>1</sup> This paper draws upon the various contributions to the "Mega-FTAs and the Global Political Economy" conference held at Berkeley in October 2014. See [http://basc.berkeley.edu/?page\\_id=22#MEGA%20FTAS](http://basc.berkeley.edu/?page_id=22#MEGA%20FTAS).

<sup>2</sup> See: World Trade Organization, "Regional Trade Agreements," [https://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](https://www.wto.org/english/tratop_e/region_e/region_e.htm).

<sup>3</sup> Vinod K. Aggarwal and John Ravenhill, *Undermining the WTO: The Case against 'Open Sectoralism'*, Asia-Pacific Issues, no. 50, (Honolulu: East-West Center, February 2001).

<sup>4</sup> Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*, (Oxford, UK: Oxford University Press, 2008).

<sup>5</sup> Office of the United States Trade Representative, "Overview of the Trans Pacific Partnership," accessed July 15, 2015, <https://ustr.gov/tpp/overview-of-the-TPP>.

<sup>6</sup> See Vinod K. Aggarwal, "The Political Economy of a Free Trade Area of the Asia-Pacific: A U.S. Perspective," in *An APEC Trade Agenda? The Political Economy of a Free Trade Area of the Asia-Pacific*, eds. Charles E. Morrison and Eduardo Pedrosa (Singapore: ISEAS, 2007), pp. 37–72.

<sup>7</sup> Claire Reilly, "Spotlight on Digital Rights as Full Trans-Pacific Partnership Text Finally Revealed," *CNET*, November 5, 2015, <http://www.cnet.com/news/spotlight-on-digital-rights-as-tpp-text-revealed-trans-pacific-partnership/>.

<sup>8</sup> Jeremy Malcolm, "How the TPP Perpetuates the Mistakes of the DMCA," *The Electronic Frontier Foundation*, December 17, 2015, <https://www.eff.org/deeplinks/2015/12/how-tpp-perpetuates-mistakes-dmca>.

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<sup>11</sup> Terence P. Jeffrey, "Will GOP Congress 'Affirm' Legitimacy of State-Owned Businesses?" *CNSNews*, February 3, 2016, <http://cnsnews.com/commentary/terence-p-jeffrey/will-gop-congress-affirm-legitimacy-state-owned-businesses>.

<sup>12</sup> Derek Scissors, "Why the Trans-Pacific Partnership Must Enhance Competitive Neutrality," *The Heritage Foundation Backgrounders* 2809, June 6, 2013, <http://www.heritage.org/research/reports/2013/06/why-the-trans-pacific-partnership-must-enhance-competitive-neutrality>.

<sup>13</sup> Joseph Stiglitz and Adam Hersh, "The Trans-Pacific Partnership Charade: TPP Isn't About 'Free' Trade At All," *MarketWatch*, October 5, 2015, <http://www.marketwatch.com/story/the-trans-pacific-partnership-charade-tpp-isnt-about-free-trade-at-all-2015-10-05>.

<sup>14</sup> United States Trade Representative, "Summary of the Trans-Pacific Partnership Agreement," Executive Office of the President, October 2015, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/summary-trans-pacific-partnership>.

<sup>15</sup> Peter A. Petri and Michael G. Plummer, "The Economic Effects of the Trans-Pacific Partnership: New Estimates," Working Paper 16-2 (Peterson Institute for International Economics, Washington, DC, 2016), <http://www.iie.com/publications/wp/wp16-2.pdf>. This study has been criticized by Jeronim Capaldo and Alex Izurieta, who attacked the underlying computable general equilibrium (CGE) model used in the earlier study as being an unrealistic representation of how countries will react. *Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement*, *Global Development and Environment Institute Working Paper No. 16-01*, January 2016.

<sup>16</sup> Csilla Lakatos et al., "Potential Macroeconomic Implications of the Trans-Pacific Partnership," *Global Economic Prospects*, January 2016, (Washington, DC: World Bank), <http://www.worldbank.org/content/dam/Worldbank/GEP/GEP2016a/Global-Economic-Prospects-January-2016-Implications-Trans-Pacific-Partnership-Agreement.pdf>.

<sup>17</sup> Barack Obama, "Here's the Deal: the Trans-Pacific Partnership," November 6, 2015, <https://www.whitehouse.gov/blog/2015/11/06/heres-deal-trans-pacific-partnership>.

<sup>18</sup> Vinod K. Aggarwal, "U.S. Free Trade Agreements and Linkages," *International Negotiation* 18 (2013): pp. 89–110.

<sup>19</sup> Brock Williams et al., *The Trans-Pacific Partnership: Strategic Implications*, R44361, Congressional Research Service, February 3, 2016.

<sup>20</sup> John Boehner et al., Letter to the House, May 7, 2015, [http://waysandmeans.house.gov/UploadedFiles/Defense\\_Formers\\_TPA\\_Letter\\_and\\_Signatories\\_5.7.2015.pdf](http://waysandmeans.house.gov/UploadedFiles/Defense_Formers_TPA_Letter_and_Signatories_5.7.2015.pdf).

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