

# BACKGROUND

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## What a Good Trans-Pacific Partnership Looks Like

*Derek Scissors, PhD*

### Abstract

*The proposed Trans-Pacific Partnership (TPP) is a major step toward building a free trade area in the Asia-Pacific. For the U.S. to benefit economically, the TPP must be a high-quality agreement that moves market-oriented liberalization forward on multiple fronts. These should include state-owned enterprises, intellectual property, and services liberalization. A sound TPP will also reinforce American political leadership in the Asia-Pacific and around the world, demonstrating that the U.S. will continue to make the decisions necessary to remain fully engaged in the global economy for the cause of open markets. The Heritage Foundation's Derek Scissors explains what a sound TPP should look like.*

Every day, U.S. policymakers are faced with choices that will determine the future of American leadership in Asia. One such set of choices involves the Trans-Pacific Partnership (TPP) currently being negotiated.

The TPP is a set of trade and investment negotiations among the U.S., Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. It is an attempt by these countries to expand the scope of the 2006 Trans-Pacific Strategic Economic Partnership (P-4) beyond the four members of Brunei, Chile, New Zealand, and Singapore. Once finalized, the TPP is intended to remain open to additional parties—eventually becoming the core of a free trade area for the Asia-Pacific.

One of the challenges the TPP faces is preventing the dilution of its original economic goals for the sake of expansion (or any other reason). In order for the U.S. to benefit economically, the TPP must be a high-quality agreement that moves market-oriented liberalization forward on multiple fronts. A sound TPP will also reinforce American political leadership in the Asia-Pacific and around the world, demonstrating that the U.S. will continue to make

### KEY POINTS

- A sound Trans-Pacific Partnership (TPP) will strengthen the U.S. economy and ensure American economic and political leadership in Asia into the future.
- In order for the U.S. to benefit economically, the TPP must be a high-quality agreement that moves market-oriented liberalization forward on multiple fronts and resists hidden protectionism.
- In particular, the TPP must aim high for new rules on state-owned enterprises, intellectual property, and various services sectors. It should include reduction of American trade barriers—in agriculture, for example.
- A failed or poor TPP would indicate to the Asia-Pacific region and the world that the U.S. is only willing to lead in situations of conflict, not toward greater cooperation.

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the decisions necessary to remain fully engaged in the global economy for the cause of open markets.

What constitutes a sound TPP? The diplomatic environment is such that a TPP will shape the global trade agenda for the next decade. Beyond the new standard reached in the U.S.–South Korea free trade agreement (KORUS), the TPP must aim high for new rules on state-owned enterprises, intellectual property, and various services sectors. It should include reduction of American trade barriers and should avoid backsliding—for example, with regard to rules of origin. Because of the precedent that the TPP will set, two steps forward in one part and one step back in another, could eventually haunt the American and world economies.

The TPP is a game-changer, economically and diplomatically. If it fails, the recent “pivot” to Asia will be seen as military in nature and America’s value as a friend or ally would be high only in case of potential conflict. The U.S. should conclude and implement a high-quality agreement as soon as possible.

### Elements of a Good TPP

The number of TPP members makes for complexity that will inhibit assessments of quality. The rationalization of national regulations and existing multilateral arrangements by itself is a daunting challenge, all the more so because the countries involved are at multiple stages of development. Ideal outcomes are not feasible, particularly for a group that hopes to expand. The TPP should be judged on the number of clear steps forward, or backward.

The perfect is also the enemy of the good in another sense—a TPP is overdue. Global trade diplomacy, topped by the World Trade Organization’s (WTO) Doha round, has flagged. A good TPP was needed yesterday. The partnership should include Japan among the initial signatories, and the U.S. should facilitate its entry into negotiations. But Japanese accession does not justify further delay.

There are many important elements of a good TPP. Liberalization should be as broad and as quick as possible, including lower non-tariff barriers and fewer restrictions

on investment and government procurement. But a good TPP must offer progress in three comparatively new areas:

1. State-owned enterprises must be restricted to a limited number of sectors;
2. Intellectual property, including trade secrets, must be better protected; and
3. There must be major service-sector liberalization, perhaps focusing on financial services.

To achieve real and considerable progress in these areas, the U.S. must be prepared to reduce barriers in agriculture, textiles, and maritime services. Further, the U.S. should avoid actions that clash with the goal of liberalization—for instance, managed trade in autos.

### State-Owned Enterprises

The TPP should be an effort to restart global liberalization. The alternative is a global economic order in which the state plays a far more prominent role.<sup>1</sup> Very large state-owned enterprises (SOEs), topped by Chinese firms but including firms from most of the major economies, have become leading global actors. That makes explicit and enforceable limits on SOEs indispensable to the TPP’s ultimate success. The two main barriers to effectively controlling SOEs are related—(1) defining them and (2) the enormous variety of subsidies available to them.

A narrow definition of SOEs may permit firms to escape classification due to superficial changes. These can include selling a small amount of stock on a public bourse, or including discrete, “private” ownership by members of its own board or even government officials.<sup>2</sup> Such a definition would negate any SOE restrictions, regardless of their content.

A broad definition is needed in order for an SOE chapter to have any meaning. Such a definition will be based on competition first and ownership second: For instance, SOEs exist wherever governments have a capital stake in a firm and sharply or repeatedly suppress competition on

1. Wojciech Ostrowski, “State Capitalism: An Emerging Regime,” *Polinares Working Paper* No. 51, December 2012, [http://www.polinares.eu/docs/d4-1/polinares\\_wp4\\_chapter1.pdf](http://www.polinares.eu/docs/d4-1/polinares_wp4_chapter1.pdf) (accessed March 4, 2013).

2. Organization for Economic Co-operation and Development (OECD), “Ownership Structures in MENA Countries: Listed Companies, State-Owned, Family Enterprises and Some Policy Implications,” September 13, 2005, pp. 3 and 16, <http://www.oecd.org/mena/investment/35402110.pdf> (accessed March 4, 2013); Aldo Musacchio and Sergio G. Lazzarini, “Leviathan in Business: Varieties of State Capitalism and their Implications for Economic Performance,” *Harvard Business School Working Paper* No. 12-108, June 4, 2012, <http://www.hbs.edu/faculty/Publication%20Files/12-108.pdf> (accessed March 4, 2013); and OECD, “Corporate Governance of State-Owned Enterprises: Change and Reform in OECD Countries since 2005,” September 14, 2011, <https://www1.oecd.org/corporate/corporateaffairs/corporategovernanceofstate-ownedenterprises/48512721.pdf> (accessed February 10, 2013).

TABLE 1

## Major State-Owned Enterprises

Name	2012 Fortune Rank
Sinopec	5
CNPC	6
State Grid	7
Japan Post	13
Gazprom	15
ENI	17
ING	18
General Motors	19
Petrobras	23
Fannie Mae	26
Nippon Telephone and Telegraph	29
BNP Paribas	30

Source: CNNMoney, "Global 500," July 23, 2013, [http://money.cnn.com/magazines/fortune/global500/2012/full\\_list/index.html](http://money.cnn.com/magazines/fortune/global500/2012/full_list/index.html) (accessed March 4, 2013).

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the behalf of that firm, by any means. This will include multiple entities in the U.S. The growing role of, and threat from, SOEs makes the gain for the U.S. from a broad definition far larger than the costs.<sup>3</sup> American policymakers must realize this trade-off, and overrule internal political objections to a broad definition.

Given a broad definition, it will be far more effective to restrict the presence of SOEs than to restrict the assistance they receive. That is, SOEs should be barred from most industries. Requiring that they simply operate on a more commercial basis will not work. Some governments will claim that they already operate on a commercial basis for extended periods, but this is entirely insufficient. A firm that would have failed a year ago—but was rescued by the government—cannot truly be operating on a commercial basis now since, on a commercial basis, it would no longer be operating at all.

Governments have developed too many means of

support for SOEs, featuring a range of financial subsidies not currently bound by the WTO and regulatory exemptions from competition, sometimes justified by vague reference to national security in connection with a "strategic" industry.<sup>4</sup> Identifying these channels for a particular set of countries at a particular time begs for governments to work to circumvent prohibitions, for example, by selectively offering benefits to domestic private players. A prolonged game of cat and mouse, not a substantial rollback of SOEs, will ensue.

Second and more important, the very existence of SOEs should be understood as an effort by governments to limit market competition and increase state control in a particular sector. That is: an effort precisely to retain sector participants which do not operate on a commercial basis. The goal should not be to pretend to commercialize SOEs in opposition to the reason for their existence, but to permit their operation in a minimal number of areas. SOEs should be banned from most sectors of the economy.

Where TPP member states insist on retaining SOEs, their market share should be capped at as low a level as possible, to forestall absurd claims that state firms completely dominate markets due to competitive superiority. This can be done on an annual basis. SOEs should set revenue targets based on total sector revenue from the previous year. Exceeding these revenue targets by a given amount, say 5 percent, would permit legal retaliation from countries whose firms operate in the sector.

Because SOEs represent circumscribed competition at home, their investments overseas can properly be considered by host countries as different from investment by companies that earn commercial profits at home. In turn, though, host countries should not be able to simply bar SOEs or extort concessions in return for market access, but should commit to a clear set of treatment guidelines.<sup>5</sup>

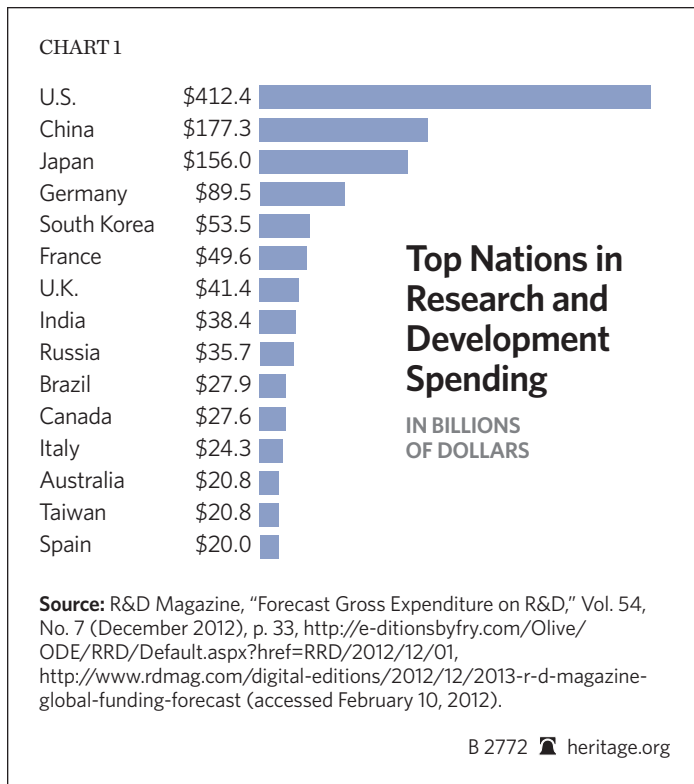
## Intellectual Property

Voluntary trade is mutually beneficial—otherwise one side would decline to participate—and following comparative advantage maximizes this mutual benefit. At the national level, the main American comparative advantage

3. Xi Li, Xuewen Liu, and Yong Wang, "A Model of China's State Capitalism," Federal Reserve Bank of Dallas, May 16, 2012, [http://www.dallasfed.org/assets/documents/institute/events/2012/linkages\\_yang1.pdf](http://www.dallasfed.org/assets/documents/institute/events/2012/linkages_yang1.pdf) (accessed March 4, 2013).

4. Derek Scissors, "The Most Important Chinese Trade Barriers," Heritage Foundation *Testimony*, July 20, 2012, <http://www.heritage.org/research/testimony/2012/07/the-most-important-chinese-trade-barriers>.

5. Investment Canada Act, "Guidelines—Investment by State-Owned Enterprises—Net Benefit Assessment," Industry Canada, <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2> (accessed March 4, 2013), and Matthew Rennie and Fiona Lindsay, "Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and Their Relevance for Other Countries," OECD, August 2011, <http://www.oecd.org/daf/corporateaffairs/corporategovernanceofstate-ownedenterprises/48510172.pdf> (accessed February 8, 2013).



is in innovation, both in terms of how the economic system works and in terms of the resources devoted. Violations of intellectual property (IP) cut at the heart of this comparative advantage, reducing trade benefits for the U.S. and eroding public support. It is therefore quite right for American negotiators to place IP at the center of international economic discussions. Protecting IP will also benefit other TPP members, both now and in the future.

IP is a far-ranging issue even with a group at a similar level of development; with the TPP, the countries involved offer very different challenges in protecting IP. There is no chance the IP issues with all these countries can actually be resolved; a reasonable goal is current improvement

and conditions for future improvement. A "TRIPS+" approach—expanding the WTO's "Trade-Related Aspects of Intellectual Property Rights" framework—is appropriate in principle. Such an approach was employed in the KORUS agreement,<sup>6</sup> but the variation among TPP countries means that priorities within TRIPS+ will have to be set, since not all members are capable of all expansions of TRIPS.

When determining priorities, the U.S. should avoid three past mistakes: (1) emphasizing criminal punishments for violators that are never enforced; (2) focusing on specific sectors; and (3) believing partners will come to accept the need for IP protection within a fairly short time.<sup>7</sup>

It could be decades before some TPP members, and prospective members, see self-interest in protecting IP that belongs to foreigners. As long as specializing in innovation is not viable, as is true in most of the world, stealing will remain an attractive alternative. The response, though, is not to prioritize criminal punishments everywhere. The rule of law is stronger in some places, such as Singapore, than in others, such as Vietnam. In addition, an emphasis on pharmaceuticals or another sector is likely to prove shortsighted as IP issues shift across sectors and the TPP draws new members.<sup>8</sup>

A good point of emphasis within IP is trade secrets. Many governments, including some TPP members, may be genuinely unable in the near term to enforce IP protection across the whole of society. With trade secrets, though, governments themselves are involved.

Traditionally, theft of trade secrets has meant that IP shared with governments by foreign firms for legal and regulatory reasons is not being protected. This is often connected to SOEs. Some governments reveal trade secrets to enable their own enterprises to compete with multinational corporations; others practice coercive technology transfer.<sup>9</sup> Strong rules limiting government prerogatives with regard to sharing trade secrets and

6. Office of the United States Trade Representative, "Intellectual Property Rights in the U.S.-South Korea Trade Agreement," <http://www.ustr.gov/uskoreaFTA/IPR> (accessed March 4, 2013).

7. Peter K. Yu, "The U.S.-China Dispute Over TRIPS Enforcement," Drake University Law School, October 2010, p. 3, <http://www.law.drake.edu/academics/ip/docs/ipResearch-op5.pdf> (accessed March 4, 2013); Vinod Aggarwal, "Reluctance to Lead: U.S. Trade Policy in Flux," *Business and Politics*, Vol. 11, No. 3 (2009), p. 3, <http://bascc.berkeley.edu/pdf/articles/Reluctance%20to%20Lead%20US%20Trade%20Policy%20in%20Flux.pdf> (accessed March 4, 2013); and Minxin Pei, "Intellectual Property Rights: A Survey of the Major Issues," Asia Business Council, September 2005, p. 6, <http://www.asiabusinesscouncil.org/docs/IntellectualPropertyRights.pdf> (accessed March 4, 2013).

8. Ian F. Fergusson and Bruce Vaughn, "The Trans-Pacific Partnership Agreement," Congressional Research Service, January 10, 2011, [http://assets.opencrs.com/rpts/R40502\\_20110110.pdf](http://assets.opencrs.com/rpts/R40502_20110110.pdf) (accessed March 4, 2013).

9. 2011 U.S. Intellectual Property Enforcement Coordinator, "Annual Report on Intellectual Property Enforcement," The White House, March 2012, [http://www.whitehouse.gov/sites/default/files/omb/IPEC/ipec\\_annual\\_report\\_mar2012.pdf](http://www.whitehouse.gov/sites/default/files/omb/IPEC/ipec_annual_report_mar2012.pdf) (accessed March 4, 2013).

providing compensation when these are lost are more feasibly crafted and enforced than broad IP statutes meant to apply to all.

Further, such obligations could serve as the foundation for an accord concerning the new way governments suborn theft of trade secrets: cyber-espionage. A February 2013 initiative in trade secrets protection from the U.S., inspired by aggressive Chinese behavior, provides initial steps only,<sup>10</sup> inadequate for discouraging predatory behavior. To shape an effective global response, the TPP must do more. One possibility is to treat theft of trade secrets as equivalent to government-imposed illegal trade barriers and permit responses along the lines of WTO cross-retaliation.<sup>11</sup> This would discourage cyber-theft while legalizing and controlling the inevitable retaliation.

## Services

Services share several features with intellectual property. Both are areas of American comparative advantage that need to be pressed in the TPP, and then elsewhere, on partners that sometimes want to accord them secondary consideration. Both are also broad in scope. With services, since American comparative advantage will shift over time and this is a newer area of liberalization than goods, there is more than one path to follow that will bring intense benefits. Precedent here is more important than the specific steps.

One route that recent negotiations have taken is expanding the use of negative lists. A negative list specifies the sectors protected from changes, creating a presumption of liberalization. (Its opposite, a positive list, specifies only the areas to which liberalization applies.) In many agreements, a negative list has been applied to services investment—services provided entirely within a country by a subsidiary established there through investment by a foreign entity. Services trade, by contrast, is buying and selling across national borders by independent

entities based in different countries. The TPP should apply a short negative list to services trade as well.

Second in priority to use of a negative list is identifying particular areas for enhanced liberalization. An obvious first choice for the U.S. is financial services. These are not treated separately in the original P-4 agreement,<sup>12</sup> but are a mainstay of the American economy. To varying degrees, greater openness in financial sectors will benefit all TPP members. While the extent of liberalization in particular areas of finance will be controversial, the specific results will be less important to long-term U.S. interests than the precedent of including substantial financial services liberalization as part of TPP, as this will be the basis for any expansion of TPP and future agreements with other parties.

## American Offers

One argument the U.S. has often made, correctly, to its trade partners is that liberalization is not a concession. Liberalization benefits the implementing country. Independent research has demonstrated again and again that the bulk of the gains from international economic agreements do not stem from greater access to overseas markets, as is commonly argued when approval of the deals is sought. Rather, most gains stem from increased openness and competition at home.<sup>13</sup>

This does not only apply to America's partners, of course. Because the American market is largely open already, the areas where it remains closed stand out. In particular, the U.S. has comparative advantages in agriculture and services, yet retains protectionist policies in both areas. Combining efficiency and scale, U.S. agriculture is by far the world's leader. Farmers and the country as a whole would benefit greatly from open global markets.

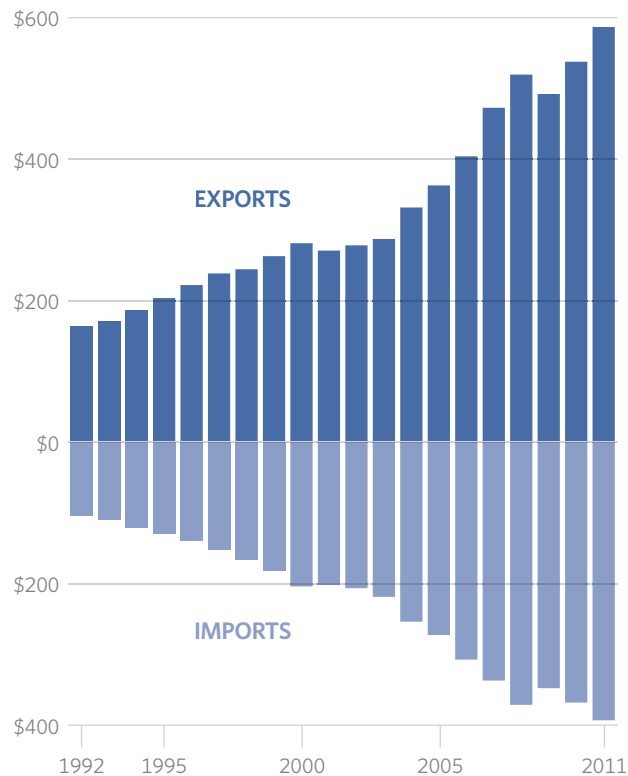
Yet the U.S. gives its trade partners reason to remain closed by selectively protecting its own market.<sup>14</sup> Just as valuable precedents will be set through the inclusion of

10. "Administration Strategy on Mitigating the Theft of U.S. Trade Secrets," The White House, February 2013, [http://www.whitehouse.gov/sites/default/files/omb/IPEC/admin\\_strategy\\_on\\_mitigating\\_the\\_theft\\_of\\_u.s.\\_trade\\_secrets.pdf](http://www.whitehouse.gov/sites/default/files/omb/IPEC/admin_strategy_on_mitigating_the_theft_of_u.s._trade_secrets.pdf) (accessed March 4, 2013).
11. International Chamber of Commerce, "Cross-Retaliation Under the WTO Dispute Settlement Mechanism Involving TRIPS Provisions," June 29, 2012, [http://www.wto.org/english/forums\\_e/ngo\\_e/cross\\_retaliation\\_2012\\_e.pdf](http://www.wto.org/english/forums_e/ngo_e/cross_retaliation_2012_e.pdf) (accessed March 4, 2013).
12. Trans-Pacific Strategic Economic Partnership Agreement, Main Agreement, pp. 11-19, <http://www.mfat.govt.nz/downloads/trade-agreement/transpacific/main-agreement.pdf> (accessed March 4, 2013).
13. Antoine Bouet, "The Expected Benefits of Trade Liberalization for World Income and Development: Opening the 'Black Box' of Global Trade Modeling," International Food Policy Research Institute *Food Policy Review* No. 8, 2008, <http://www.ifpri.org/sites/default/files/publications/pv08.pdf> (accessed March 4, 2013), and Gregory Corcos, Massimo Del Gatto, Giordano Mion, and Gianmarco I. P. Ottaviano, "Productivity and Firm Selection: Quantifying the 'New' Gains from Trade," Intangible Assets and Regional Economic Growth *Working Paper* No. 05/14, March 2009, [http://www.iareg.org/fileadmin/iareg/media/papers/wp5-14\\_Corcos\\_Del\\_Gatto\\_Mion\\_Ottaviano.pdf](http://www.iareg.org/fileadmin/iareg/media/papers/wp5-14_Corcos_Del_Gatto_Mion_Ottaviano.pdf) (accessed March 4, 2013).
14. Chris Edwards, "Agricultural Regulations and Trade Barriers," CATO Institute, June 2009, <http://www.downsizinggovernment.org/agriculture/regulations-and-trade-barriers> (accessed March 4, 2013).

CHART 2

## Value of U.S. Cross-Border Services Trade Nearing \$1 Trillion

IN BILLIONS OF DOLLARS



Source: U.S. Department of Commerce, Bureau of Economic Analysis, "Detailed Statistics for Cross-Border Trade," 1992–2011, [http://www.bea.gov/international/international\\_services.htm#detailedstatisticsfor](http://www.bea.gov/international/international_services.htm#detailedstatisticsfor), (accessed February 10, 2013).

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financial services in TPP liberalization, the U.S. should reduce tariffs and other barriers—to foreign sugar and

dairy, especially. Liberalization in these areas does not have to be completed within the TPP, but it is long past time for it to begin.

Agriculture is the main area for self-defeating American protectionism, but maritime services may see the single most self-defeating U.S. policy. The Merchant Marine Act of 1920 (the Jones Act) requires all goods transported by water between American ports be carried in U.S.-flagged and U.S.-built ships, 75 percent owned and manned by U.S. citizens. It is a restriction of competition that benefits the American shipping industry and costs American consumers, especially as domestic natural gas production soars. It also justifies services markets restrictions by other countries, harming a huge range of U.S. services companies.<sup>15</sup>

Another area of longtime American recalcitrance is textiles. Here, the U.S. is not fighting the last war, it is fighting a war from the 19th century. Textile and apparel imports benefit consumers, especially poorer consumers who are more vulnerable to price increases for these goods.<sup>16</sup>

Moreover, the jobs supported by imports far outweigh remaining production jobs. Textile and apparel production employed about 384,000 people in the U.S. at the end of 2012. American imports of Chinese apparel alone help support close to that number of jobs in offloading, transport, and retail.<sup>17</sup> Apparel imports from China are less than half the total. Liberalization in textiles would help the U.S. while offering considerable benefits to current and prospective future TPP members.

### Pitfalls the U.S. Should Avoid

There are also things the U.S. should not do. Rules of origin are a double-edged sword in a multilateral arrangement like the TPP. Unless rules of origin are rationalized among participating countries, companies often ignore the opportunities offered by new trade agreements because complying with the new rules of origin is too

15. Merchant Marine Act of 1920, 46 U.S. Code § 27, 2002, p. 6, [http://www.upa.pdx.edu/IMS/currentprojects/TAHv3/Content/PDFs/Jones\\_Act\\_1920.pdf](http://www.upa.pdx.edu/IMS/currentprojects/TAHv3/Content/PDFs/Jones_Act_1920.pdf) (accessed March 4, 2013), and Terry Miller and James Jay Carafano, "Lets Pull the Plug on the Jones Act," Heritage Foundation *Commentary*, July 3, 2010, <http://www.heritage.org/research/commentary/2010/07/lets-pull-the-plug-on-the-jones-act>.

16. Christian Broda and John Romalis, "Inequality and Prices: Does China Benefit the Poor in America?" Banco de Portugal, March 10, 2008, p. 2, [http://www.bportugal.pt/en-US/EstudosEconomicos/Conferencias/Documents/2008MonetaryPolicy/John\\_Romalis.pdf](http://www.bportugal.pt/en-US/EstudosEconomicos/Conferencias/Documents/2008MonetaryPolicy/John_Romalis.pdf) (accessed March 4, 2013).

17. Bureau of Labor Statistics, "Current Employment Statistics—CES (National), 2012," <http://www.bls.gov/web/empsit/ceseeb1a.htm> (accessed March 4, 2013), and Derek Scissors, Charlotte Espinoza, and Terry Miller, "Trade Freedom: How Imports Support U.S. Jobs," Heritage Foundation *Background* No. 2725, September 12, 2012, <http://www.heritage.org/research/reports/2012/09/trade-freedom-how-imports-support-us-jobs> (accessed March 4, 2013).

CHART 3

## U.S. Agricultural Trade Continues Steady Growth

IN BILLIONS OF DOLLARS



Source: U.S. Census Bureau, "U.S. International Trade Statistics," December 2012, [http://censtats.census.gov/naics3\\_6/naics3\\_6.shtml](http://censtats.census.gov/naics3_6/naics3_6.shtml) (accessed February 10, 2013).

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complicated.<sup>18</sup> Rationalizing rules of origin is a core element of any successful trade agreement.

What must not occur is the tightening of the rules of origin as the free trade net is cast wider. This would not be trade creation and liberalization, it would be trade diversion and exclusion.<sup>19</sup> It would change the TPP from a group that can be easily expanded and is intended in part to restart global trade progress to a group that hastens the formation of dangerous blocs.

The same caution applies to labor and environment provisions. There is nothing wrong with mutually agreed-upon labor and environment provisions unless they introduce restrictions on trade and investment. These kinds of restriction are inevitably used as precedents to attack open markets.<sup>20</sup> A broad scope for the TPP will be beneficial as long as the chapters on the newly introduced topics do not clash with the goal of liberalization.

Finally, the U.S. should minimize exclusions, such as those granted in KORUS for rice on the Korean side and, essentially, managed trade for autos on the American side.<sup>21</sup> The TPP should be an opportunity to move forward, not backward. In general, as few items as possible should be exempted through these mechanisms or inclusion on negative lists.

### Timing

A sound TPP would greatly benefit the U.S. and its partners. The faster it is in place, the sooner the gains would be realized—gains that are especially needed now with chronically weak American and global economies. And there are still more reasons to speed up the TPP process.

The WTO Doha round is all but dead. The U.S. chiefly blames India and China,<sup>22</sup> although the recent American contribution is also suspect. If Indian and Chinese

18. Paul Brenton, "Notes on Rules of Origin with Implications for Regional Integration on Southeast Asia," PECC Trade Forum, April 22-23, 2003, [http://www.pecc.org/publications/papers/trade-papers/4\\_ROO/2-brenton.pdf](http://www.pecc.org/publications/papers/trade-papers/4_ROO/2-brenton.pdf) (accessed March 4, 2013); Masahiro Kawai and Ganeshan Wignaraja, "The Asian 'Noodle Bowl': Is It Serious for Business?" Asian Development Bank Institute *Working Paper* No. 136, April 2009, <http://www.adbi.org/files/2009.04.14.wp136.asian.noodle.bowl.serious.business.pdf> (accessed March 4, 2013); and Carolyn L. Evans, "Bilateralism, Multilateralism, and Trade Rules," Federal Reserve Bank of San Francisco *Economic Letter*, January 9, 2012, <http://www.frbsf.org/publications/economics/letter/2012/el2012-01.html> (accessed March 4, 2013).
19. "Rules of Origin, Communication from Hong Kong," GATT Negotiating Group on Non-Tariff Measures, September 15, 1989, [http://www.wto.org/gatt\\_docs/English/SULPDF/92080053.pdf](http://www.wto.org/gatt_docs/English/SULPDF/92080053.pdf) (accessed March 4, 2013).
20. Byron Dorgan and Sherrod Brown, "How Free Trade Hurts," *The Washington Post*, December 23, 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/12/22/AR2006122201020.html> (accessed March 4, 2013).
21. William H. Cooper et al., "The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications," Congressional Research Service, August 9, 2011, <http://fpc.state.gov/documents/organization/171373.pdf> (accessed March 4, 2013).
22. Faizel Ismail, "Is the Doha Round Dead? What Is the Way Forward?" University of Manchester Brooks World Poverty Institute *Working Paper* No. 167, May 2012, <http://www.bwpi.manchester.ac.uk/resources/Working-Papers/bwpi-wp-16712.pdf> (accessed March 4, 2013), and Alan Beattie, "Negotiators Sift Debris," *Financial Times*, July 29, 2008, <http://www.ft.com/intl/cms/s/0/dde1e23a-5da0-11dd-8129-000077b07658.html> (accessed March 4, 2013).

recalcitrance is indeed the major barrier to global liberalization, the TPP is the best available tool to induce cooperation from them. The same is true for Japan, an ally of the U.S. but one that has struggled with trade liberalization. Japanese participation in the TPP should be welcome, when Tokyo can move quickly. If it cannot do so at the moment, then a finished, functioning TPP may speed Japanese action.

For its part, American trade policy has bordered on stagnant for six years. If KORUS had been ratified in late 2007, upon completion, it might have been possible to make considerable progress on the then-embryonic TPP in 2008. Had the Obama Administration not been critical of imports early on,<sup>23</sup> it might have been possible to make more progress on the TPP in 2010. Instead, the U.S. economy has suffered from restrictions on competition here and overseas. Global trade has become effectively less liberal, as other players created regional accords of often dubious quality.<sup>24</sup> A TPP failure risks not only more lost benefits, but the continuing erosion of the U.S.-built post-war economic system.

## High Stakes

There are two different ways the TPP process can fail: (1) no agreement or (2) a bad agreement. The first has unpleasant political implications; the second has unpleasant economic implications.

On the economic side, the inclusion of Canada and Mexico makes the TPP a heavyweight. The two countries accounted for 29 percent of American trade in 2012. Singapore and Australia add a few more percentage points. If TPP candidates Japan and Korea are added, the share passes 40 percent of U.S. trade.<sup>25</sup> Even these numbers do not tell the full story, however.

With the new U.S.–EU free trade initiative, the TPP is no longer the only game in town. But it is difficult to imagine a failed or empty TPP being followed by a powerhouse U.S.–EU accord. The political environment for both will

be challenging. If the American side is not willing to move forward on genuine liberalization with TPP partners, there is little reason to believe it will do so with the EU. The TPP's share of American trade may be 30 percent to 40 percent, but it likely represents the whole of American trade policy in terms of whether valuable progress will be made in the next few years. The stagnation at the WTO and in genuine trade liberalization more broadly puts a heavy burden on the TPP to be a strong agreement, not any agreement.

The TPP also affects American leadership. Respective shares of world trade show China making strides in bolstering its claim to economic parity with the U.S. Asserting American leadership in this context requires a powerful response, starting with a sound TPP.

Absent a high-quality TPP, trade development in Asia will be governed by the Regional Comprehensive Economic Partnership (RCEP). RCEP is to be composed of the Association of Southeast Asian Nations (ASEAN) and its current free trade agreement partners—Australia, China, India, Japan, New Zealand, and South Korea.

In terms of economic benefits, the RCEP should be no match for a successful TPP. Like all of ASEAN's FTAs, the agreement is likely to be far less liberalizing—focused primarily on goods and offering multiple exclusions and differential treatment. Some RCEP countries, such as Thailand, are natural candidates for the TPP in the future. However, a failed or vacuous TPP leaves even the limited RCEP as the only active vehicle for trade and investment liberalization in Asia—and the U.S. on the outside looking in.<sup>26</sup> (The U.S. is not a candidate for the RCEP as it has no FTA with ASEAN and is not likely to have one in the foreseeable future.)

Finally, if the TPP fails outright, the recent American “pivot” to Asia will be seen as purely military in nature. America's value as a friend and ally would be high only in case of potential conflict, a somewhat self-defeating position. Along these lines, a TPP collapse would allow China

23. News release, “Obama Administration Strengthens Enforcement of U.S. Trade Laws in Support of President's National Export Initiative,” United States Department of Commerce, August 26, 2010, <http://www.commerce.gov/news/press-releases/2010/08/26/obama-administration-strengthens-enforcement-us-trade-laws-support-pr> (accessed March 4, 2013).

24. Julia Gray, “Politics and Patronage: The Function of Dysfunctional Regional Trade Agreements,” Princeton University, April 23, 2010, [http://www.princeton.edu/~pcglobal/conferences/ptas/Gray\\_pta\\_paper.pdf](http://www.princeton.edu/~pcglobal/conferences/ptas/Gray_pta_paper.pdf) (accessed March 4, 2013); Pascal Mossay and Takatoshi Tabuchi, “Preferential Trade Agreements Harm Third Countries,” University of Reading and University of Tokyo, September 14, 2012, <http://ideas.repec.org/p/cor/louvco/2012035.html> (accessed March 4, 2013); and Australian Government, “Bilateral and Regional Trade Agreements,” *Productivity Commission Research Report*, November 2010, [http://www.pc.gov.au/\\_data/assets/pdf\\_file/0010/104203/trade-agreements-report.pdf](http://www.pc.gov.au/_data/assets/pdf_file/0010/104203/trade-agreements-report.pdf) (accessed March 4, 2013).

25. United States Census Bureau, “Top Trading Partners—Total Trade, Exports, Imports, Year-to-Date December 2012,” <http://www.census.gov/foreign-trade/statistics/highlights/top/top1212yr.html> (accessed March 4, 2013).

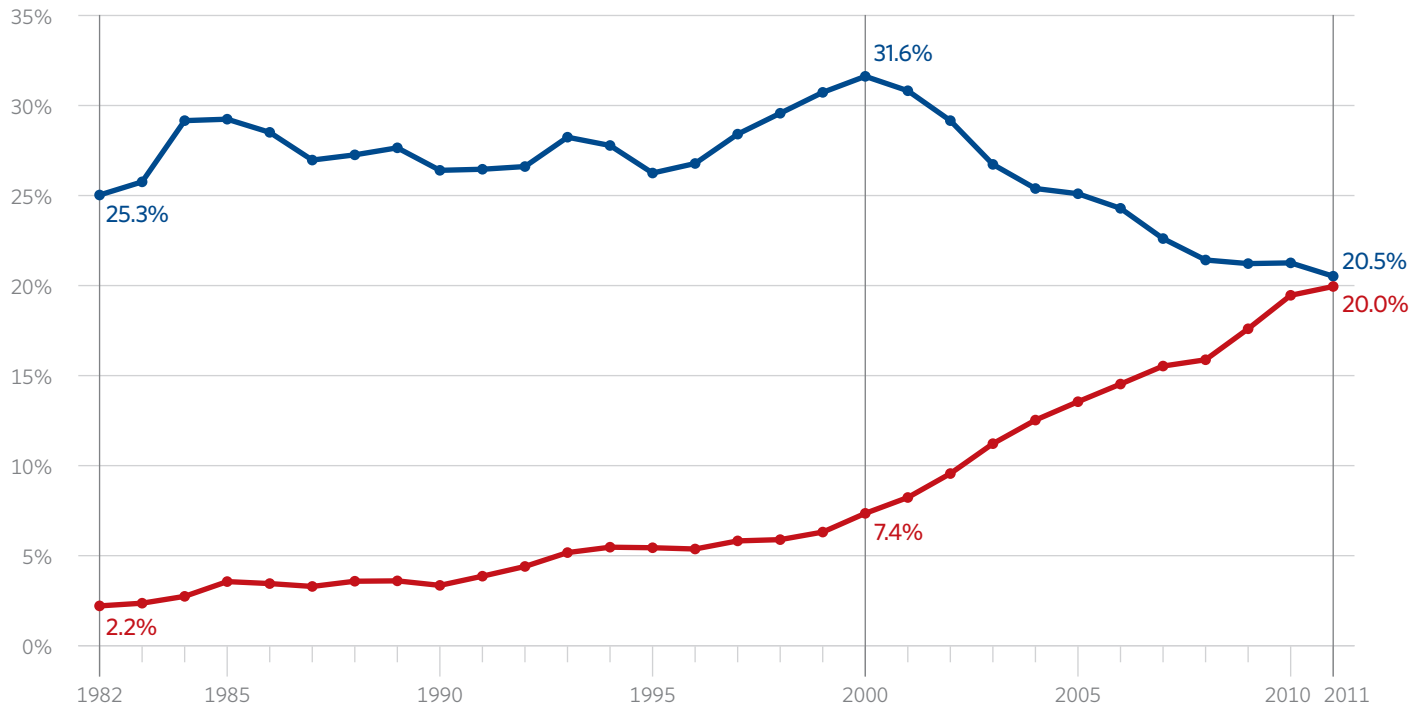
26. Sanchita Basu Das, “RCEP and TPP: Comparisons and Concerns,” Institute of Southeast Asian Studies, January 7, 2013, [http://www.iseas.edu.sg/documents/publication/ISEAS%20Perspective%202013\\_2.pdf](http://www.iseas.edu.sg/documents/publication/ISEAS%20Perspective%202013_2.pdf) (accessed March 4, 2013).



CHART 4

## China Has Nearly Matched the U.S. in Total Trade

TOTAL TRADE VOLUME AS A PERCENTAGE OF WORLD EXPORTS



Source: World Trade Organization, Statistics Database, 2013, <http://stat.wto.org/Home/WSDBHome.aspx?Language> (accessed March 5, 2013).

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to portray itself as leading when it comes to progress in the Asia-Pacific and indicate that the U.S. only leads when the situation deteriorates.

### A Good Trans-Pacific Partnership

In order to achieve a sound TPP, the U.S. should:

- 1. Restrict the operating space of SOEs to specified sectors and cap their market shares there.** Trying to govern SOE behavior will not work.
- 2. Seek to bind governments, rather than entire societies, when it comes to IP.** Coercive government acquisition of trade secrets should be subject to legal, structured retaliation.
- 3. Insist on a negative list approach in services trade.** At least one major financial sub-sector should be included in the areas of fresh liberalization.

- 4. Take clear steps to address the most egregious American trade protections.** Dairy and sugar are obvious choices, but textiles and maritime services should also be opened.
- 5. Conclude and implement a high-quality agreement as quickly as possible.** At this point, speed is more important, and the extent of true liberalization far more important, than the number of initial signatories.
- 6. Keep rules of origin at least as loose as in the KORUS agreement.**
- 7. Minimize the number of exceptional areas, such as autos.**

The TPP must be a high-quality agreement and it is already overdue. A TPP with little economic value-added will harm American interests indefinitely. A sound TPP

will strengthen the U.S. economy and ensure American economic and political leadership in Asia into the future.

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