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Henry S. GAO

Singapore Management University, henrygao@smu.edu.sg

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Selected Issues in TPP Negotiations and Implications for China

*Henry Gao**

I From the P₄ to the TPP

The Trans-Pacific Strategic Economic Partnership Agreement is also known as the Pacific-4, or the P₄ Agreement as it started out as a free trade agreement between 4 Pacific countries, i.e., Brunei, Chile, New Zealand and Singapore.¹ The history of economic integration among the P₄ members can be traced back to the 1990s, when Chile and New Zealand first started exploring the possibility for an FTA.² While the bilateral talks were suspended after only two rounds of negotiations due to Chile's concerns on the potential impact on its agricultural sector, the idea re-emerged in 2000, shortly after New Zealand and Singapore announced the negotiation of an FTA. This time it took the form of a trilateral Closer Economic Partnership (CEP) involving all three countries. Originally conceptualized as the "Pacific Three" (P₃) Agreement, its proponents also hoped that the Agreement could pave the way for wider trade liberalization in the APEC region that would lead to a P₅ scheme, i.e., Australia and the US in addition to the original three countries.

After the CEP between New Zealand and Singapore entered into force in 2001, the three countries re-assessed the likelihood of different alternatives and decided that the time might not be ripe for the P₅ as neither the US nor Australia was keen. Instead, the parties should try to get the P₃ off the ground first. In 2002, the P₃ negotiation was re-launched during the APEC leader's meeting in Los Cabos, Mexico. From 2003 to 2005, five rounds of negotiations were held. Brunei participated in the negotiations as an observer from the

* Associate Professor, School of Law, Singapore Management University; Dongfang Scholar Chair Professor, Shanghai Institute of Foreign Trade. LLB, China; LLM, London; JD, Vanderbilt. Email: gaoheny@gmail.com. The author is grateful to Professors Hu Jiaxiang and Matthias Vanhullebusch for their kind invitation to the Symposium on Regional Cooperation and Free Trade Agreements in Asia at the Asian Law Centre of KoGuan Law School of Shanghai Jiao Tong University in December 2013, where this paper was first presented. The author wishes to thank Professors Hu, Vanhullebusch, and other participants at the symposium for their kind comments on the paper. All errors remain the author's own.

1 Fta.gov.sg (2005).

2 Salazar (2005).

second round, and then requested to join as a formal member just before the final round of negotiations in April 2005. On 3 June 2005, the parties announced the successful conclusion of the negotiations at the APEC meeting in Jeju, Korea. The Agreement entered into force in 2006.

II A Unique Agreement

Compared with most other FTAs in Asia, the TPP has several unique features:

First, the memberships of the other FTAs are mostly restricted to the Members in Asia. In contrast, from the very beginning, the TPP is a trans-regional agreement that spans across three continents, i.e., Asia (Singapore and Brunei), Oceania (NZ) and Americas (Chile).

Second, other FTAs are mostly sponsored by a big Power (such as the US or China) or a Regional group (such as ASEAN or EU), but the TPP was initiated by three smaller countries which, according to most common benchmarks such as land mass, population, and GDP, are at best middle Powers.

Third, most other FTAs are rather exclusive and automatically close their doors after the initial agreement is signed. If any other country wishes to join the FTA, it has to first persuade all existing members to accept it, which is not an easy task. In contrast, the TPP was negotiated with an “open-accession” clause that allows “any APEC economy or other state” to seek accession (Article 20.6).

Fourth, while many FTAs have been criticized in one way or the other, the TPP has been widely hailed as a “high standard” agreement since the very beginning.³ In a previous article, I argued that this claim is largely a myth.⁴ For example, in terms of the tariff reduction, the TPP only offer negligible benefits due to the low pre-FTA tariffs and small bilateral trade volumes. Why, then, did the parties negotiate the Agreement in the first place?

The answer was provided by Juan Salazar, the Chilean Ambassador to New Zealand, who argued that “the initiative was, from the very beginning, not supposed to be a typical Free Trade Agreement (FTA)” that aims at “increasing bilateral flows of merchandise.”⁵ Instead, the parties really wanted to use the Agreement to build “a larger scheme for a Closer Economic Partnership (CEP)” with the following goals:

3 See e.g., Ministry of Trade and Industry of Singapore (2005); Ustr.gov (2008b).

4 Gao (2010), p. 221–240.

5 Salazar (2005).

- (a) use the Agreement as a benchmark for trade liberalization among APEC economies and create a demonstration effect for the WTO;
- (b) use the Agreement to promote political cooperation between countries with similar political philosophies; and
- (c) use the Agreement to forge potential strategic alliance on a wide array of areas ranging from agricultural, education to technology.⁶

Of the three objectives, the first one is most relevant from the perspective of trade policy and worth further discussion. As small, open and export-oriented economies, the P4 countries are highly dependent on trade. Thus, they have to push harder for world trade liberalization than their larger and less export-dependent trade partners. When multilateral negotiations don't move forward, they will have to resort to bilateral or regional initiatives to create more market access opportunities for their exports and eventually increase the momentum for trade liberalization on the wider platform. While the P4 countries themselves might not have sufficient political clout to move negotiations at the WTO, the initiative could serve as a stepping-stone for an expanded "Px" agreement within APEC. Indeed, as we discussed in the previous part, one of the explicit objectives of the original P3 initiative was to entice the US and Australia joining the Agreement.

III The TPP and the US

Given the small sizes of the original P4 economies, it seems rather puzzling that the US would pay any attention to such an agreement. What is so special about the P4 Agreement? What is in it for the US? In the view of the author, the main benefits to the US for joining the TPP are the following:

First, the Agreement can help the US to continue its presence and engagement in the Asia Pacific region. While Asia is a latecomer in regional integration compared to Europe and the Americas, the progress of regionalization has intensified during the past decade. The US has managed to score FTAs with Australia, Singapore and Korea, but so far the US has largely been left out in the integration efforts in the region. Indeed, as noted by an official USTR document, other than the three FTAs signed by the US, there are now 175 FTAs involving Asia-Pacific countries, with more than 70 other agreements in the pipeline, all excluding the US.⁷ Moreover, in the grand scheme of things, Asia

6 Ibid.

7 Ustr.gov (2009).

Pacific countries seem to grow accustomed to working without the US. Before the US launched the TPP negotiations in 2010, there were five competing models for region-wide integration in Asia Pacific: “ASEAN plus Three,” i.e., the ten ASEAN countries plus China, Japan and Korea; “ASEAN plus Six,” i.e., India, Australia and New Zealand on top of the countries in the first model; the East Asia Community (EAC) backed by Japan;⁸ the Free Trade Area of the Asia-Pacific (FTAAP);⁹ and the Australian proposal for an Asia-Pacific Community (APC).¹⁰ Among them, the first two definitely exclude the US. As to the EAC, while Japan has never made clear the exact nature of its membership, it seems rather absurd if anyone were to argue that the US be considered as an East Asian country. For the APC, while Australia has not predefined the potential members, it seems reasonable to presume that the US would be included given the strong US-Australia alliance and the inclusion of the word “Pacific” in its title. Similarly, the FTAAP most likely would include the US as well. In summary, among the five models of regional integration in Asia pre-2010, only two would involve the US. The additional problem is that these two, i.e., the APC and the FTAAP, are also the least attractive: given the extremely large and diverse membership of the two models, it is almost impossible for either model to lead to legally binding agreements. In contrast, the TPP Agreement provides the perfect vehicle for the US to cherry-pick those Asian countries which are not only economically meaningful but also strategically important to the US and conclude Agreement with them.

Second, the Agreement can help the US to achieve important strategic objectives. As argued eloquently by Fred Bergsten and Jeffrey Schott in their submission to the USTR in support of the TPP Agreement on behalf of the Peterson Institute for International Economics:

Since the beginning of APEC in 1989, many Asian countries have strongly advocated US involvement in the organization in order to ensure continued US economic and military engagement in the region as a balance against Chinese hegemony. Former Prime Minister Lee Kuan Yew of Singapore, on a visit to Washington in late 2009, warned of the risk of increasing Chinese dominance over its Asian neighbors—and decreasing US relevance—should the United States fail to engage economically and politically in the region. Japan, Korea, and the ASEAN countries all

8 For more information, see the website of the Council on East Asian Community (2014). See also Termsak (2002).

9 Bergsten (2007).

10 Apc2009conference.org (2009).

seek to maintain active US engagement as a “hedging strategy” against the rise of China. Economic tensions between the United States and China, and the increased risks of Asia-Pacific disintegration due to the advent of Asia-only economic arrangements, underline the need for effective transpacific linkages and institutional ties for security as well as economic reasons.¹¹

In short, the P4 Agreement would help the US to maintain its security ties in the region through enhanced integration with economies in the region.

Third, negotiations on the TPP Agreement could also provide the US with the testing ground for different types of trade agreements. While the Bush Administration has already been criticized by many developing countries for trying to force the US model on its FTA partners, one can still argue that the topics the US demanded in FTAs, such as investment, services liberalization, government procurement, and intellectual property rights protection, are trade issues. In contrast, the Obama Administration seems to be taking an even more radical view on what FTAs are about. In a speech he made in December 2009, USTR Ron Kirk summed up the new approach as “a true 21st century trade agreement” that “will reflect U.S. priorities and values, enhance American competitiveness, and generate job-creating opportunities for American businesses and workers.” While this might sound rather ambiguous, Kirk provided some hints on the new strategy in his letter to the Congress on the TPP Agreement by noting that the US will try to negotiate additional commitments on “environmental protection and conservation, transparency, workers’ rights and protections, and development.” As the first major trade agreement ever seriously negotiated by the Obama Administration, the TPP Agreement is very likely to have major implications on the future direction of the US FTA policy or even overall trade policy.

Fourth, the economic potential of the TPP is also quite substantial. While the US is no longer in recession, the pace of recovery has been much slower than expected. Unlike China, which can stimulate growth by encouraging more domestic consumption, the US economy has long suffered from over-consumption and low savings rate. Thus, increasing export is the only realistic way to help the US speed up the recovery. That’s why Obama launched the National Export Initiative in 2010 to double the US export in five years.¹² This target cannot be achieved without engaging the Asian Pacific region, which accounts for 60% of the US exports. While the total US exports to the

11 Bergsten & Schott (2010).

12 Whitehouse.gov (2010b).

P4 countries is only 5% of its worldwide exports, the TPP will be a much bigger game if other countries in the region also join in.

Although initially sceptical, the US became interested and joined the talks when the P4 countries began work on the outstanding chapters on Financial Services and Investment in March 2008.¹³ Building on this work, the US also started to seriously explore the possibility of joining the entire agreement.¹⁴ On September 22, 2008, the USTR announced the launch of the negotiations for the US to accede to the P4 Agreement.¹⁵ The first round of negotiations was originally scheduled in March 2009, but this was put on hold due to the change of administration in early 2009. On November 14, 2009, Obama finally announced in Tokyo that the US was ready to start the formal negotiations.¹⁶ The first round of negotiations was held from March 15 to 19, 2010 in Melbourne, Australia. In addition to the US and the original P4 countries, Australia, Peru and Viet Nam also joined at the negotiating table.¹⁷ After two more rounds in San Francisco and Brunei, New Zealand hosted the fourth round in Oakland with Malaysia being welcomed into the negotiations. In 2012, Mexico and Canada also joined the negotiations. At the 18th Round in July 2013, Japan became the newest member.¹⁸ In addition to these twelve countries, Korea,¹⁹ Philippines, Thailand, Indonesia and Taiwan have all expressed interest in joining the Agreement at some point.

IV Negotiation Process: High Standard Meets Low Politics

In an article published in 2012, I discussed both the architectural and substantive issues of the TPP negotiations.²⁰ As the negotiations were still in early stages at that time, I made some predictions and suggestions on how the negotiations should be conducted if the US is indeed serious about concluding a “high-standard” agreement. Some of these predictions turned out to be correct. For example, I argued that, as the P4 itself carried some birth defects, it should not be simply transplanted into the new TPP agreement.²¹ Instead,

13 Ustr.gov (2008).

14 Ustr.gov (2008).

15 Ibid.

16 Whitehouse.gov (2010a).

17 Ustr.gov (2010).

18 Ustr.gov (2013b).

19 Ustr.gov (2013a).

20 Gao (2012), p. 64–81.

21 Ibid., p. 64–72.

the US should use this opportunity to transform the P4 Agreement into something better. This was indeed the approach taken, as is shown by the Outlines of TPP Agreement, which goes well beyond the framework of the old P4 Agreement.²² On the other hand, some of my suggestions didn't go down well with the negotiators. Instead, judging from the progress of the negotiation so far, it appears that the lofty goal of "high standard" has once again become a victim of low politics. In this Section, I will briefly discuss the negotiating process on some of the main issues. Due to space constraint, I will focus on five issues, i.e., market access on goods, rules of origin, trade in services, investor-state dispute settlement, disciplines on state-owned enterprises, and environmental provisions.

A *Market Access on Goods*

The US initially preferred to conduct market access negotiations on two different tracks:²³ First, for those countries that already have FTAs with the US, the US simply maintains the tariff schedules in the existing FTAs.²⁴ This way, the existing schedules will not be re-opened, and the US may maintain its protection on sensitive products excluded from previous FTAs, such as sugar products in its FTA with Australia.²⁵ Second, bilateral negotiations will be held among parties without existing FTAs. However, this is likely to result in the same product being subject to different tariff rates depending on its country of origin. Thus, the more liberal countries such as Australia, New Zealand and Singapore have been pushing for plurilateral negotiations between all TPP members to establish a single, unified tariff schedule among all members.²⁶ In September 2010, the members agreed to adopt a hybrid approach, whereby each member may decide whether to make its tariff reduction offers on a bilateral or multilateral basis.²⁷ In late 2011, the members further agreed that the tariff schedule will cover all goods, representing some 11,000 tariff lines.²⁸ The latest text indicates that the market access package will provide "comprehensive, duty-free" access to most of the goods, with some sensitive products as exceptions.²⁹

22 Ustr.gov (2011b).

23 Elms & Lim (2012), p. 32–39.

24 Inside US Trade (2010a).

25 For a discussion of the sugar issue, see Elms (2012), p. 116–117.

26 Inside US Trade (2010b).

27 Inside US Trade (2010c).

28 Ustr.gov (2011).

29 TPP Trade Ministers' Report to Leaders, 8 October 2013.

B *Rules of Origin (ROO)*

The goal of the ROO negotiations is to “develop trade-facilitating rules of origin that encourage accumulation across the region, which will promote production and supply chains between the TPP countries and make it much easier for businesses, both large and small, to take advantage of the agreement.” At the start of negotiations, rules of origin appeared to be a difficult issue as the US has a history of adopting rather restrictive and complex ROOs in its previous FTAs.³⁰ While the members have been able to agree “on a significant share of these rules,”³¹ problems would still remain in several sectors. For example, the US textile industry has lobbied for the inclusion of a yarn-forwarding rule for textile imports, which requires all components of an apparel item, starting with the yarn, to originate in TPP countries to qualify for the lower tariff under the TPP.³² This means that TPP countries like Vietnam will greatly reduce or even stop importing fabrics from non-TPP countries like China. Of course, this will also increase the price of apparel imports due to the higher production costs for fabrics in TPP countries. To appease the US apparel retailers and importers who might be affected by this, the US also proposed a short-supply list, which allows the usage of non-TPP fabrics in certain items that are deemed to be in “short supply” among TPP countries. This creates a partial exception to the yard-forwarding rule and the list current includes 215 items.³³

C *Trade in Services*

The services negotiation in the TPP is conducted on a “negative-list” basis, which means that all sectors and modes of supply must be liberalized unless non-conforming measures are noted in a particular sector or mode.³⁴ This is the preferred approach by the US in its FTAs as it usually results in more market access opportunities than the traditional GATS-type “positive-list” approach, where no commitment is undertaken on a sector or mode unless it is been specifically included in the schedule of specific commitments.³⁵

30 See Gao (2012), p. 73–74, Liang (2012), p. 129–131.

31 TPP Trade Ministers’ Report to Leaders, 8 October 2013.

32 Inside US Trade (2013c).

33 Inside US Trade (2013d).

34 See Harbinson & Lim (2012), p. 136–138.

35 GATS, Article XX.

As the negative list approach is new to several TPP members such as Malaysia and Vietnam,³⁶ there were some difficulties in the negotiations at first as they were over-cautious³⁷ and tried to carve out the “entire universe.”³⁸ However, with the technical assistance provided by the US, they gradually overcame the fear of the negative-list approach and the negotiations moved on.³⁹

Notwithstanding the progress made, problems still remain in individual sectors. For example, Malaysia maintains caps on foreign equity in sectors such as financial services, insurance, telecommunications and retail, where the US has keen interests.⁴⁰ The US is reluctant to open the maritime services sector, as the Jones Act requires that cargo transportation between US ports must be provided by US-flagged vessels.⁴¹ Singapore is against a US proposal to restrict the ability of countries to impose capital controls in case of financial crisis.⁴² Japan has problems in the postal services and insurance sectors, which are dominated by state-owned Japan Post.⁴³ Given these problems, while the members have improved their offers in the past year, they still have some way to go before they can achieve the aim of a “high-standard” outcome in the services area.⁴⁴

D Investor-state Dispute Settlement

The controversy over investor-state dispute settlement mechanism in the TPP is relatively well-known, with the US pushing for its incorporation while Australia and New Zealand seeking its exclusion.⁴⁵ Their opposition to the mechanism largely stems from the fear that foreign investors might use the mechanism to limit the policy space available to the government on various issues, as illustrated by the recent challenge brought by Philip Morris under the Australia-Hong Kong Bilateral Investment Treaty⁴⁶ against the plain

36 Inside US Trade (2012d).

37 Inside US Trade (2012a).

38 Inside US Trade (2012e).

39 Ibid.

40 Inside US Trade (2012c).

41 Inside US Trade (2013e).

42 Inside US Trade (2013j); Inside US Trade (2012b).

43 Inside US Trade (2013b).

44 TPP Trade Ministers' Report to Leaders, 8 October 2013.

45 See Chaisse (2012), p. 153–155.

46 legislation.gov.hk (1993).

packaging requirement imposed by the Australian government.⁴⁷ However, with the change of government in late 2013, Australia appears to be ready to take a more flexible approach on the issue, especially if the US can offer additional market access for Australian exports.⁴⁸ In the end, the mechanism will probably be incorporated in the final agreement.

However, its scope of coverage might not be extensive as the US has hoped, as several members have resisted US proposal to cover disputes over the fulfilment of obligations to provide most favoured nation treatment, national treatment and the minimum standard of treatment to investments in the financial services sector.⁴⁹ This is opposed not only by close US allies like Canada, but also by domestic US financial regulators such as the Treasury Department, Federal Reserve and the Securities and Exchange Commission, which tried to shield themselves from such challenges.⁵⁰ Similarly, the US proposal to have the mechanism cover public concession contracts granted by the government to private firms on either public services or infrastructure projects also faces challenges from negotiating partners.⁵¹

E *Disciplines on State-owned Enterprises*

Another controversial issue is the disciplines on SOEs, which started out with several countries such as Vietnam, Malaysia, Singapore and Brunei opposing it, while the two main supporters, the US and Australia, tabling conflicting proposals.⁵² The Australian proposal incorporates its domestic “competitive neutrality” rules, under which state-owned firms essentially reimburse the national government for any advantages they receive by virtue of their government ownership.⁵³ In contrast, the US prefers imposing transparency requirements as well as disciplines to ensure that SOEs do not receive advantages that distort their competition with private firms in commercial markets.⁵⁴

In July 2013, Australia and the US finally agreed to a consolidated text that highlights the similarities and differences between their two proposals.⁵⁵ Meanwhile, Vietnam also shows willingness to soften its position in exchange

47 Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12, <http://www.italaw.com/cases/851> (accessed 9 December 2013).

48 Inside US Trade (2013h).

49 Inside US Trade (2013f).

50 Ibid.

51 Ibid.

52 Inside US Trade (2013a).

53 Ibid. For a discussion of the principle, see Capobianco and Christiansen (2011).

54 Inside US Trade (2013a).

55 Ibid.

for adequate concessions from the US on apparel and footwear products, as it is trying to reform its SOEs anyway.⁵⁶

However, its two ASEAN friends are still holding out. Singapore is concerned with overly-intrusive transparency requirements which could affect the operation of its SOEs, as well as rules that would scrutinize even firms with only partial ownership by its state-owned investment firm Tamasek Holdings.⁵⁷ On the other hand, Malaysia is concerned with the impact of the disciplines on the role of SOEs regarding “provision of public goods and services, development of strategic industries and implementation of socio-development programmes.”⁵⁸ It tries to seek flexibilities that would allow the continued existence of such firms to provide public and social goods and services.⁵⁹ In contrast, while Japan is also concerned with the impact of the SOE rules on its SOEs such as Japan Tobacco, Nippon Telegraph and Telephone, and Japan Post, it might be willing to offer concessions if other countries make “fair” concessions in exchange, especially in the financial services sector.⁶⁰

In the end, while some kind of rules on SOEs could be incorporated into the TPP, it probably would also be subject to country-specific exceptions.

F *Environment, Labour and Human Rights Issues*

Along with market access, IPR and SOEs, environment has been identified by US trade officials as one of the four most difficult areas in the negotiations.⁶¹ Labour is also a thorny issue for the US due to resistances from both some TPP partners as well as domestic constituencies.⁶² As I mentioned in my 2012 article, there are many issues regarding the inclusion of non-traditional trade issues such as environment, labour and human rights:⁶³

The first issue relate to the format of the agreements: should issues such as environment, labour and human rights be incorporated as chapters in the main agreement or as side deals annexed to the main agreement? In the P4 Agreement, these issues did not find their way into the main agreement. Instead, cooperation on environmental protection was included as a side agreement, with labour as a Memorandum of Understanding (MoU). In

56 Ibid.

57 Ibid.

58 Malaysia Ministry of International Trade and Industry, Brief on the TPP (2014).

59 Ibid.

60 Inside US Trade (2013b).

61 Inside US Trade (2013i). For a discussion of the environmental issues in the TPP, see Schott & Muir (2012).

62 See Elliott (2012).

63 Gao (2012), p. 75–78.

contrast, the US FTAs with Australia, Chile, Peru and Singapore all included environment and labour as chapters in the main agreement. This is in line with the position taken in the May 2007 Bipartisan Agreement on Trade Policy⁶⁴ and the “Trade Reform, Accountability, Development, and Employment (TRADE) Act” Bill, which reflect the US positions on these issues.⁶⁵ Thus, it is very likely that environment and labour will be incorporated as formal chapters in the agreement rather than side agreements. As to human rights, even though the TRADE Act also calls for its incorporation into the core agreement, the Bipartisan Agreement is silent on the issue. Moreover, other than labour rights, human rights are not featured in the existing US FTAs either. Thus, it is unlikely to be included as a formal chapter.

The second issue is the choice of language for the new issues: should the provisions contain only soft, non-binding language, or formal, legally-enforceable language? In the P4 agreement, the side agreements use only best-endeavour languages that do not really create legally binding obligations. Moreover, the side agreements explicitly recognize the parties have “sovereign rights to set their own policies and national priorities and to set, administer and enforce their own laws and regulations” on the subject. In contrast, much stronger language was used in the more recent US FTAs, where the best-endeavour language of “strive to” was replaced with “shall.” As this is a demand in both the Bipartisan Agreement and the TRADE Act, we will probably find rather formal language that is legally enforceable in the new TPP Agreement.

The third issue is how detailed the obligation shall be: shall the obligation only refer to adherence to general international standards or shall references be made to specific international instruments? With regard to environment, the P4 agreement only refers vaguely to the “respective multilateral environment commitments” of the members but never made clear as to which specific multilateral environment agreements (MEAs) are included in these commitments. In contrast, the US FTAs explicitly refers to a specific list of seven MEAs covering matters such as endangered species, ozone layer, whaling, etc. As to labour, while the P4 agreement refers to “the principles of the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up (1998),” the US FTAs goes one step further by explicitly listing the principles in its FTAs, i.e., freedom of association, right to collective bargaining, elimination of forced labour, abolition of child labour, and discrimination on employment and occupation. On these two issues, given the strong interest of the US on these issues

64 Ustr.gov (2007).

65 Gao (2012), p. 75.

as evidenced in the Bipartisan Agreement and the TRADE Act, it's very likely that the new TPP agreement will follow the US approach.

The fourth issue is how to incorporate the obligations into the domestic legal regime. The P4 Agreement only includes vague language for the members to ensure that their relevant "laws, regulations, policies and practices in harmony with its international commitments." This falls short of requiring the members to adopt the international standard, as harmonization can be achieved through adoption of similar but not identical standards. In contrast, the US FTAs explicitly requires that the relevant international standards, such as the five core ILO principles, to be adopted and maintained in the laws and regulations of the trade partner.⁶⁶ Failure to do so is regarded as violation of a legal obligation. Again, the US position is confirmed by the Bipartisan Agreement and the TRADE Act and this is likely to be reflected into the new TPP agreement.

The next issue is the enforcement of these obligations. The P4 agreement chooses the least intrusive approach by leaving it to each member to "set, administer and enforce its own laws, regulations and policies according to its priorities." Any relaxation or failure to enforce such laws is only deemed as "inappropriate" rather than "illegal." In contrast, enforcement failures are grounds for violation claims under the US FTAs. Of course, there are two important pre-conditions for the claim: First, the failure must be demonstrated "through a sustained or recurring course of action or inaction." In other words, a few isolated incidents of failure will not be sufficient as the ground for a violation claim. Second, the failure must occur "in a manner affecting trade or investment." While both elements are affirmed by the Bipartisan agreement, the TRADE Act takes a bolder position and removes both conditions. In my view, even the milder version of the US position is hard to swallow for some TPP members, such as Vietnam or Malaysia. The problem is not so much with the first condition, as countries with inadequate regulatory and enforcement framework on labour and environment issues are guaranteed to have "sustained or recurring" failures. Instead, it is the second condition that's going to be problematic. Interpreted broadly, "in a manner affecting trade or investment" can be taken to include any enforcement failures. For example, even enforcement failures that affect only domestic producers or domestic markets of one country can be argued to have an impact on the competitiveness of the imports from the FTA partners into the domestic market of the first country. In my view, unless the US is willing to back off slightly and settle with language

66 See e.g., Article 19.2 of the KORUS FTA.

such as “directly affecting trade or investment” the other members might not be willing to accept such an obligation.

The last issue is regarding dispute settlement. As the P4 agreement does not create legally binding obligations, there is no formal dispute settlement mechanism regarding these issues in the agreement. Instead, the only recourse a party has is to hold bilateral consultation with the other trade partner or refer the matter for discussion before the FTA Commission. In contrast, the US FTAs explicitly provides for the use of the same dispute settlement mechanism as regarding the trade obligations. Moreover, trade sanctions can be imposed for violations. While this arrangement is also confirmed by the Bipartisan Agreement and the TRADE Act, I’m not sure this will go down well with the other TPP members. In all likelihood, there will be strong resistance from countries such as Vietnam or Malaysia. Whether or not they will agree to the provision in the end will depend on a lot of factors, including the value of the market access concessions they can get from the US.

Indeed, most of these issues turned out to be controversial in the negotiations, with different countries having problems with different parts of the U.S. proposal.⁶⁷

V The China Question

As the TPP keeps snowballing to include more and more Asia Pacific economies, it seems rather puzzling that China, one of the most important economies in the region, has so far been absent. The preferred explanation among Chinese commentators is that the exclusion of China is deliberate as the US wants to use the TPP to contain China. For a long time, the US government has been denying this theory. However, at the height of the election campaign in 2012, Obama finally admitted this, by noting that “we’re organizing trade relations with *countries other than China* so that China starts feeling more pressure about meeting basic international standards” (emphases added).⁶⁸ In October 2013, Obama further confirmed that the exclusion of China from TPP is for strategic reasons by stating that “[i]f we can get a trade deal with *all the other countries in Asia* [...] that’ll help us in our negotiations with China.”⁶⁹

On the other hand, Western commentators tend to believe that China was not interested in the TPP as it was not ready to meet the high-standards.

67 Inside US Trade (2013k).

68 Presidency.ucsb (2012).

69 Inside US Trade (2013g) (emphasis added).

However, China's position seems to be changing. Earlier last year, the Ministry of Commerce stated that it is evaluating the pros and cons of joining the TPP, and this is widely interpreted as an indication of its interest in joining the TPP.⁷⁰

Whether China likes it or not, the TPP is already there and seems likely to be concluded within the next two years, if not longer. How should China deal with the TPP? Strategically speaking, there are three possible options for China.

The first option is totally ignoring the TPP. This seemed to be the approach taken by China for the first two years after the launch of the TPP negotiations. It made sense as it is consistent with China's traditional approach on FTAs. As I mentioned in an earlier article,⁷¹ China's RTAs tend to have a narrower coverage than those negotiated by other major players, such as the USA, EU or Japan. Normally, China would start with an agreement that covers trade in goods only and would expand to services only after commitments on goods have been substantially implemented. With regard to the issues that are not traditionally trade-related, such as environmental protection, competition policy and labour standards, China has been reluctant to include them as part of the FTA package, though recently it has shown some willingness to incorporate them. Nonetheless, in line with its cautious approach, China has largely preferred to address these in standalone side agreements or MOUs, rather than through FTAs.

However, burying its head in the sand is the worst possible option for China. The reason is simple: the US will not only use the TPP to enhance its economic ties with Asia Pacific countries, but also make rules on key issues such as SOEs, e-commerce, government procurement, etc. without the involvement by China. Once these rules are set, the US is likely to push for their global acceptance in the WTO, and it would be hard for China to resist them given the support by TPP members.

The second option is trying to join the TPP as soon as possible. As stated by the Mexican Economy Secretary Bruno Ferrari when Mexico applied to join the TPP in late 2011, "the most important part is to participate in designing the rules of the TPP, not just enter into the TPP."⁷² By entering the TPP negotiations, China could play some role in designing the new rules. However, the US probably will not want China's participation before the conclusion of the negotiations as it would make it more difficult for the US to control the direction of the negotiations. Moreover, even if China manages to get in, it has to

70 News.xinhuanet.Xinhua (2013); Spegele (2013); Reuters.com (2013).

71 Gao (2011b), p. 104–120.

72 Inside US Trade (2011g).

face procedural hurdles in the accession process. While there are no explicit rules on accession, the experience of other countries which have joined the TPP negotiations half-way suggested that the following are the likely steps for new applicants:⁷³

First, in terms of the process, the applicant has to consult with current TPP members on a bilateral basis, in addition to meeting in parallel with TPP members as a group.⁷⁴

Second, in terms of the substance, the country has to demonstrate that it can “live up to the high standards of the TPP agreement”⁷⁵ by addressing issues of concern for all TPP members, and must be willing to make concessions in specific areas of interests.⁷⁶ For example, when Japan applied, it was asked to provide better access for U.S. agricultural exports such as beef, market access for autos, pharmaceuticals and medical devices, as well as insurance services.⁷⁷ Also, the new member has to accept everything that has been agreed by existing members in the new negotiations and may not re-open any concluded issue for discussion.⁷⁸

Third, to admit a new member, the existing members have to reach a consensus decision. Of course, for obvious reasons, the view of the US is the most important.⁷⁹

Fourth, before being admitted as a full member, an applicant may start out as an “associate member.” As such, the applicant may observe three rounds of negotiations without having to assume all the responsibilities of the full members. However, it must commit to full participation by the time of the fourth round.

Given the complicated accession process, again China could be subject to high demands from the existing members, especially the US. Thus, this is not an attractive option for China either.

The third option is trying to make its own set of rules in its existing and new FTAs. In my view, this is the best option for China as it can prevent the dominance of the US approach. The difficulty, however, is that China’s capacity in rule-making seems to be lacking. As I discussed in another article, even in the Doha Round where the negotiations mainly focus on traditional trade issues,

73 Inside US Trade (2011d).

74 Ibid. See also Inside US Trade (2011c); Inside US Trade (2011d).

75 Inside US Trade (2011b).

76 Inside US Trade (2011e).

77 Inside US Trade (2011c).

78 Inside US Trade (2011a); Inside US Trade (2011b).

79 Inside US Trade (2011f).

China has not been able to introduce many meaningful new rules.⁸⁰ While China has made more than 100 submissions as of July 2008,⁸¹ most of its proposals focuses on either the procedural issues or the special and differential treatment for developing countries and do not touch on the substance of the negotiation. Similarly, if we take a look at China's existing FTAs, we can see that China hasn't really used them to make new rules either. The only exception is the recognition of its status as a market economy, which China has demanded as a *sine qua non* from every negotiating partner.⁸² The reason for this is that, as the price for its WTO accession, China has agreed to be treated as a non-market economy.⁸³ This makes it easier for other countries to find the existence of dumping in anti-dumping investigations against China. Given the structural problems in the WTO decision-making process, it is difficult for China to change its non-market economy status in the multilateral trading system. The remaining option is for China to negotiate with each of its trade partners to recognize China's market economy status. Because it has much more bargaining power at the bilateral/regional level, this strategy seems to be working. As of the end of 2011, 81 economies have recognized the market economy status of China.⁸⁴

Thus, it seems even more unlikely that China could come up a different set of rules on the issues covered by the TPP, many of which are cutting-edge issues. To solve the problem, China could consider seeking help from scholars and think-tanks, especially those based overseas who have studied the various issues for a long time. Moreover, China may also wish to use the Shanghai Free Trade Zone as a testing ground for new ideas before they can be committed to at the national level.

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80 Gao (2014).

81 Zhang (2008).

82 Gao (2011a), p. 174-175.

83 For a detailed discussion of the non-market economy issue, see Gao (2007), p. 55.

84 Mofcom.gov.cn (2012).

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