

Global Agenda Council on Trade & Foreign Direct Investment

# Mega-regional Trade Agreements Game-Changers or Costly Distractions for the World Trading System?

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# Abbreviations

AGOA	African Growth and Opportunities Act
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BITs	Bilateral investment treaties
BRICS	Brazil, Russia, India, China and South Africa
CJK FTA	China-Japan-South Korea Free Trade Agreement
COMESA	Common Market for Eastern and Southern Africa
DDA	Doha Development Agenda
EAC	East African Community
EAFTA	East Asia Free Trade Area
EBA	Everything but Arms
EU	European Union
FDI	Foreign direct investment
FTA	Free trade agreement
FTAAP	Free Trade Area of the Asia-Pacific
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GVC	Global value chains
IIA	International investment agreement
IPR	Intellectual property rights
LDCs	Least developed countries
MFN	Most favoured nation
OECD	Organisation for Economic Co-operation and Development
RCEP	Regional comprehensive economic partnership
RTA	Regional trade agreement
SADC	Southern Africa Development Community
SPS	Sanitary and phytosanitary standards
STE	State trading enterprise
TBT	Technical barriers to trade
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TRIPs	Trade Related Aspects of Intellectual Property Rights
TTIP	Trans-Atlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization

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Peter Draper, Senior Research Fellow, Economic Diplomacy Programme, South African Institute of International Affairs, South Africa

Salma Hareb, Chief Executive Officer, Economic Zones World, United Arab Emirates

Gary C. Hufbauer, Senior Fellow, Peterson Institute for International Economics, USA

Salim Ismail, Group Chairman and Chief Executive Officer, Groupe Socota, Mauritius

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Mario Marconini, Managing Director, Teneo Strategy, Brazil

Ricardo Meléndez-Ortiz, Chief Executive, International Centre for Trade and Sustainable Development (ICTSD), Switzerland

Susan C. Schwab, Professor of Public Policy, University of Maryland, and Strategic Advisor, Mayer Brown, USA

Sherry Stephenson, Senior Fellow, International Centre for Trade and Sustainable Development (ICTSD), Switzerland

Guillermo Valles-Galmés, Director, International Trade in Goods, Services and Commodities Division, United Nations Conference on Trade and Development (UNCTAD), Geneva

Wan Meng, Dean, School of Law, Beijing Foreign Studies University, People's Republic of China

Wang Yong, Director, Center for International Political Economy Research, Peking University, People's Republic of China

# Executive Summary

## Anabel González

The World Economic Forum's Global Agenda Council on Trade & Foreign Direct Investment is pleased to present the report *Mega-regional Trade Agreements: Game-Changers or Costly Distractions for the World Trading System?* In continuing with the aim to inform the policy debate on critical issues to shape the global trade agenda, the objective of this document is to explore the impact mega-regionals may have on countries that are not part of the negotiations. It highlights opportunities and challenges in promoting the coexistence of these agreements – should they come to fruition – with the multilateral trading system.

This is probably the most important topic in the international trade scenario today. If current negotiations are successful, there is great potential for unleashing new opportunities and bringing about more growth to the world economy, while injecting dynamism into the multilateral trading system. But there is also concern that the discrimination they entail may increase friction in trade relations, fostering greater fragmentation and the weakening of the multilateral trading system. Moreover, there is concern about the geopolitical impact of these agreements.

There is no single view on the impact of mega-regionals on non-members and it is not the purpose of this report to present one. Rather, it showcases different angles of the discussion while highlighting the relevance of consciously facilitating the relationship between mega-regionalism and the multilateral trading system, for the benefit of all countries.

This is a comprehensive report organized in six sections, each drafted by different Council Members. Below is a brief summary of each section.

### Section 2. Setting the Stage

#### 2.1. Mega-regionals: What Is Going on? – Ricardo Meléndez-Ortiz

World Trade Organization (WTO) members have been active in negotiating regional trade agreements (RTAs), among which mega-regional RTAs (mega-regionals) now occupy centre stage. Mega-regionals are deep integration partnerships between countries or regions with a major share of world trade and foreign direct investment (FDI), and in which two or more of the parties are in a paramount driver position, or serve as hubs, in global value chains. Beyond

market access, emphasis in this integration is on the quest for regulatory compatibility and a rules basket aimed at ironing out differences in investment and business climates.

This report's focus is on mega-regionals, and on the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP) in particular. They are singled out given their conformity with criteria that profiles them as a potential new pillar of trade governance, complementary to the multilateral trade system: the agreement would affect a share of at least a quarter of world trade in goods and services and of global FDI; at least two economies party to the agreement are hubs in global value chains (GVCs) as evidenced by their share of trade intermediate goods and tasks in the regions involved; the agreement's coverage goes deeper and beyond the WTO, RTAs and bilateral investment treaties (BITs), addressing a minimum of areas and regulatory reform essential to 21st century world markets; and parties to the agreement are engaged in multiple RTAs with third-party economies and enjoy extensive trade and investment exchange with a significant number of non-members, making the partnership a potential reverse trade-diversion scheme.

#### 2.2. The Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP) – Key Issues and Potential Impact on Members– Peter Draper and Ricardo Meléndez-Ortiz

Originally, a four-way FTA between Brunei, Chile, New Zealand and Singapore, the TPP now encompasses eight additional countries: the US, Australia, Canada, Japan, Malaysia, Mexico, Peru and Vietnam. South Korea might join the group. The TPP aims to achieve extensive liberalization of both goods and services, and entails comprehensive coverage of trade in services, investment, government procurement, non-tariff measures and many regulatory topics. The TPP can significantly impact on global trade dynamics, given that goods trade among TPP partners amounted to more than \$2 trillion in 2012. Estimates vary as to the impact of TPP on member countries. Many see the TPP as a stepping stone to the creation of a Free Trade Agreement among all Asia-Pacific Economic Cooperation (APEC) members.

The TTIP negotiations, launched in June 2013, aim for a far-reaching trade agreement between the US and the EU, focusing on trade liberalization and behind-the-border

and other non-tariff barriers, as well as seeking a “high standards” approach to alignment, compatibility and possible harmonization of regulations and standards governing the goods, services, investment and public procurement markets. Most estimates indicate that the more significant gains from TTIP will not come from tariff reduction, but rather from the elimination of non-tariff measures and ex-ante and ex-post compatibility and alignment of standards regulation and systems that act as barriers to trade, investment and public procurement.

## Section 3. The Rationale behind Mega-regionals

### 3.1. Why Mega-regionals? – Susan Schwab and Karan Bhatia

The motivation behind any given mega-regional depends on the nature of the agreement being negotiated, on the particular countries involved, and on the point in time the decision is being made to engage or close the deal. Often, the decision to launch a mega-regional agreement is informed by geopolitical considerations. However, the ultimate success of the negotiation and the long-term viability of the arrangement turn more on strong economic and commercial considerations. While geopolitical motives may inform a decision to launch mega-regionals and other serious trade agreements, they are not sufficient to conclude or implement them.

The main affirmative reasons propelling governments to enter into mega-regionals include improved and/or preferential access to new markets; economic stimulus in an era of tight budgets; upgrading, refreshing and building out “old” agreements; achieving higher ambition agreements; addressing new issues and creating potential precedents for future multilateral agreements; improving competitiveness; and “keeping the bicycle moving forward”.

While commercially viable and economically valuable trade agreements are too difficult to negotiate to be concluded on the basis of defensive fuel alone, defensive reasons, including fear of being locked out or protection of existing preferential agreements, do inform some countries’ decision to engage and may ultimately slow down or even bring down the higher ambition results sought by others.

### 3.2. The Political Economy of the Rise of Mega-regionals – Wang Yong

The rise of mega-regionals may be explained by several factors. First, the TPP and TTIP can be perceived as the continuation of the regional cooperation trend that began by the mid-1990s, with the US and the EU as the driving nations. Second, the lack of agreement on the Doha negotiations reinforced the perception of inefficiency of policy-making at the multilateral level. Third, geopolitics contribute in part to mega-regionalism, in particular with US proponents of the TPP seeing it as a way of thwarting the emergence of a China-centred East Asia economic bloc. Fourth, mega-regionals aim to meet the liberalization needs of developed countries, promoting the creation of high standards that

could help them tap the potential of trade and investment. And, fifth, they symbolize the interest of the US and the EU to keep a decisive say in the rules applicable to trade and investment in the 21st century.

To deal with the potential trade-diverting effects of TPP and TTIP, some developing countries have begun to build their own arrangements. Mega-regionals could trigger fierce competition among different trading blocs and damage the reputation and authority of the multilateral trading system.

The deal struck in the Bali WTO ministerial meeting in December 2013 is a positive development as this package helped save the WTO from marginalization. The deal allows developing economies to relax about the future of the multilateral trading system, and succeeds in creating an easier and amicable atmosphere.

## Section 4. The Impact of Mega-regionals

### 4.1 Discrimination and Multilateralizing Potential of TPP and TTIP Provisions – Ricardo Meléndez-Ortiz

In evaluating the impact of RTAs on non-members, the discussion normally centres on their potentially discriminatory effects. In the case of the TPP and TTIP, though negotiations have not yet concluded, it is possible to get a sense of their potential impact by looking at the nature of their provisions. For this purpose, issues were divided between WTO-plus and WTO-extra and then assessed based on two criteria: the potential risk for discrimination against outsiders; and the potential for “multilateralization”, which is based on the intrinsic characteristics of the provisions or chapters in an agreement and their relative impact beyond the economies involved.

The results of applying the information available on the negotiations, the best judgement of a group of analysts is presented to conclude that provisions where limited risk of discrimination exists and with high potential for multilateralization should be encouraged from a global governance perspective.

### 4.2 The Economic Impact – Richard Baldwin

RTAs create different types of preferences, including: hard preferences that imply discrimination like in the case of tariff elimination; soft preferences, where discrimination is unfeasible in practical terms like in telecoms, given the porous nature of the rules of origin identifying the nationality of firms; and non-preferences, i.e. reforms that act like multilateral liberalization, for example the commitment to adhere to an international convention on intellectual property. Mega-regionals like the TPP and TTIP will create some new tariff discrimination, but not much. Deeper-than-tariff provisions in deep RTAs like the TPP or TTIP need not create hard discrimination. This is particularly the case with regulatory convergence, where firms outside the mega-regional also benefit from accessing all member markets with one standard.

Recent evidence shows that most RTAs seem to be creating soft versus hard preferences. The evidence is that almost all RTAs have led to “reverse trade diversion”. That is, while the preferences increase trade among partners, RTA imports from excluded nations also rise – just not as much. This is why they are called “soft” as opposed to “hard” preferences. The RTAs create trade for members and non-members alike, but the liberalization is slanted towards members.

### 4.3. The Systemic Impact – Richard Baldwin

Mega-regionalism is good news and bad news for the world trade system. The good news is that mega-regionals will tidy up the “spaghetti bowl” of RTAs. The bad news is they may undermine world trade governance, eroding WTO centrality as the forum for creating new trade rules, with worrisome consequences.

Without reform that brings existing RTA disciplines under the WTO’s aegis and makes it easier to develop new disciplines inside the WTO system, the trend towards eroding WTO centrality will continue and possibly take it beyond the tipping point where nations ignore WTO rules since everyone else does. There is the risk of drifting back towards a 19th century “Great Powers” world.

The systemic impact of regulatory convergence deserves special mention due to its unusual effects. Both mega-regionals are likely to lead to an outcome where poor nations are induced to adopt at least some rich-nation standards. In some cases this may be good for them, but in others it may involve inappropriate restrictions.

## Section 5 – Possible Responses to Mega-regionals

### 5.1. Potential Responses to Mega-regionals by Excluded Countries – Uri Dadush

The TPP and TTIP intend to reshape world trade rules for the 21st century. However, the negotiations exclude some 160 countries, which are home to over 80% of the world’s population. Thus, how the excluded countries respond to the rise of the mega-regionals is an important question.

The starting point for formulating an appropriate response to the mega-regionals is how the agreements are likely to affect the excluded country’s defensive and offensive trade interests. While much of the impact on excluded countries will occur in specific sectors, the systemic implications of the mega-regionals cannot be ignored. If successful, the agreements could set up new benchmarks and approaches, which will either supersede WTO or eventually become integrated into WTO.

Excluded countries could in theory pursue several strategies to respond to the mega-regionals; however, the only realistic response for those worried about the systemic implications for the global trade system are “plurilateral”, or flexible geometry approaches within the WTO. Such approaches would probably form an important part of their overall national response to mega-regionals, which could also include

autonomous trade reforms and the initiation of new bilateral or regional negotiations with the contracting parties to TPP and TTIP as well as with other important trading partners, enabling them to raise the competitiveness of their productive apparatus.

### 5.2. Regional and Country Perspectives

#### 5.2.1. The Potential Impact of Mega-regionals on Sub-Saharan Africa and Least-Developed Countries in the Region – Peter Draper and Salim Ismail

Sub-Saharan Africa does not have a seat at the mega-regional negotiating tables. Yet, the region has a stake. Although the final substance and eventual ratification of TPP and TTIP negotiations remain uncertain, the ability of African nations to diversify market opportunities, integrate their economies in global value chains and attract sustainable investment could be affected. The long-term balance of benefits against risks will depend on the design of these agreements, supportive international policies and the strategic response of African policy-makers and firms. Four issues are relevant: new compliance measures; geopolitical dynamics; preference schemes; and international production networks. Transparency and monitoring will be an important basis on which sub-Saharan African nations can frame a proactive response.

One of the consequences of mega-regional activity is that the influence of sub-Saharan Africa on the global trade and investment agenda will diminish – the region relies on the WTO to be heard and has little bargaining power to promote its interests outside of the organization. Nevertheless, sub-Saharan African policy-makers can devise strategies aimed at building on the opportunities and curtailing the risks caused by the mega-regional agreements, including closely monitoring the negotiating chapters, working with partners to ensure that the potential for discrimination is minimized and creating a domestic and regional economic environment that invites confidence.

#### 5.2.2. The Potential Impact of Mega-regionals on the Asia-Pacific Region and China

##### 5.2.2.A. The Mega-regional Dynamic in Asia-Pacific and Its Potential Impact on the World Trading System – Sherry Stephenson

The TPP will have a large impact on the conclusion of other RTAs, as well as on the Asia-Pacific region itself. It should provide a stimulus for the Regional Comprehensive Economic Partnership (RCEP) and the China-Japan-South Korea (CJK) FTA talks to move forward with more vigour. It should also be a strong catalyst for the US-EU TTIP efforts, and should push China to reflect on its ultimate goals in the Asia-Pacific region. As a regional leader, China should logically wish to be a member of both, but currently only Japan is in this position. China may or may not choose to be one of the driving forces in consolidating the TPP with the RCEP provisions to move towards a Free Trade Area of the Asia-Pacific (FTAAP).



These RTAs, when concluded, will change the panorama of the world trading system. They will draw more economic activity into the region by further enhancing its dynamism and attractiveness. As they will have relatively less explicitly discriminatory effects on the rest of the world, trade diversion should not be a major worrying factor for countries outside the region. To the extent that they are “deep” agreements, they will impact patterns of trade and FDI through reinforcing and expanding existing supply chain operations. And, from an institutional perspective, a potential future TPP and RCEP, and possibly a CJK FTA, could serve as models for the WTO to draw upon to reflect on future reform, especially as the organization approaches its 20th year mark.

#### 5.2.2.B. A Geopolitical Perspective – Jean-Pierre Lehmann

While the Asia-Pacific economies are highly and tightly integrated in the contemporary international economic system and with main actors through global value chains, the politics and geopolitics of the Asia-Pacific region are reminiscent of those in Europe of the late 19th and early 20th centuries in that they are characterized by power rivalries, trade and investment in part driven by arms races and strong currents of nationalism.

In such a context, priority must be given to the rules-based multilateral trade system. Other initiatives, like the CJK FTA, the Association of Southeast Asian Nations (ASEAN) and the RCEP are to be encouraged, but a TPP is much more contentious. Even though the intention may not be geopolitical, it is impossible, given the realities in Asia-Pacific, to ignore geopolitical considerations and possible ramifications. Creating a dynamic, open, inclusive and solid trade regime in Asia-Pacific is very important but should best be left to Asian initiatives and leadership, with international support.

#### 5.2.2.C. TPP and China’s Response – Wan Meng

The TPP, which mainly includes Asian participants, ironically appears to disconnect with the regional initiatives, as it is not in the Asian integration style and as China, the trading powerhouse of Asia, is excluded from the TPP. For the US, it is a means of leveraging power and represents an alternative for developing the governance framework for international trade.

The TPP poses some concerns for China, in particular as it may result in trade diversion and its norm-setting scheme may undermine China’s leading role in Asia’s regional integration. However, China should wait for a better time to join the TPP negotiation, as the TPP confronts a number of problems and, in any case, a successful TPP calls for China’s participation.

If the TPP is not well received by participating members, China would be in a comfortable position to build on its economic leverage to participate in norm setting, and to channel the TPP into an RTA based more on a set of compromised terms. This may lead to the rise of a politically driven divergent dual-track: China taking the lead through the Asian track and the US taking the lead through the TPP track.

#### 5.2.3. Mega-regionals – How “Mega” Will Their Impact Be for Latin America? – Beatriz Leycegui

The impact of the TPP and TTIP on Latin American countries is complex and relates to whether each country has trade agreements with TPP or TTIP negotiating parties and how important those markets are for their exports, as well as their degree of participation in the mega-regionals.

In the case of the TPP, only Chile, Mexico and Peru are part of the negotiations. For Central Americans and Colombia, participating in these negotiations could be important because they have FTAs with the US and have important exports to that country. For other countries that are less dependent on the US, have a relatively small trade relationship with TPP Asian countries and have closer economies, the TPP is less attractive.

Regarding the TTIP, the greater risk of trade diversion is for the Mercosur countries, as the competitiveness of their agricultural products in the EU could be eroded as a result of the market access preferences that the EU could grant to the US. For most other countries in the region, if the TTIP were to include cumulation of origin provisions with common Latin American FTA partners, this would diminish trade-diversion effects and take trade relations to a higher level. Moreover, the TTIP could eventually converge with NAFTA and FTAs that the US and the EU have in common with Latin America, creating one of the largest mega-regional agreements.

### Section 6 – Facilitating the Relationship between Mega-regionals and the Multilateral Trading System – Robert Lawrence

Several measures could help ensure that mega-regional agreements complement rather than undermine the multilateral trading system. First, parties should consciously craft agreements that are open to additional members and that create more integrated and contestable markets for firms based in both member and non-member countries. This could also be made if mega-regionals implement general rules that improve regulatory transparency and allow full participation by all foreign firms in the development of standards, liberalize services on a most favoured nation (MFN) basis and adopt trade facilitation measures that apply to all their trade.

Second, information and assessments on the mega-regionals could be provided by the WTO and by official institutions and/or think tanks to encourage arrangements that lead to a more open international trading system. This should be achieved by improving transparency, exchanges on best practices and reviews of the systemic impacts of these agreements.

Finally, countries could strengthen the role and maintain the centrality of the WTO in the trading system. This could be achieved by moving towards a variable geometry, in which obligations to which all members adhere are complemented by deeper, open plurilateral agreements that members are obliged to join. Innovations in mega-regionals could serve as models for negotiating plurilaterals with broader WTO membership.

## Section 7 – Thinking about Failure – Gary Hufbauer

Success in TPP and TTIP negotiations cannot be taken for granted as they both face tremendous challenges. In the case of the TPP, the two main obstacles are the possibility that Japan may not be able to agree to significantly liberalizing agriculture and services – which may then have agricultural and service exporters within the TPP threatening to walk out of the negotiations – and the domestic opposition to the TPP in the US Congress, from both Democrats and Republicans. In the case of the TTIP, the sheer complexity of the deal, the resistance of independent regulatory agencies on both sides, and the opposition of states to federal mandates either to open procurement or to harmonize product regulations and professional standards, are the main roadblocks to the success of the negotiating process.

If the two mega-regionals either fail outright or do not deliver as expected, and if the WTO stumbles as a serious negotiating forum, the years 2013-2015 might well be called the Great Turning Point in post-Second World War policy liberalization, when fresh policy liberalization, on the scale enjoyed from 1950 to 2000, ceased to be part of the picture. In this setting, it seems unlikely that global trade and investment can serve as the great drivers of world growth and prosperity that they were in the half-century after the Second World War.

# 1. Introduction

## Anabel González

A lot is happening on the trade negotiations front in almost every corner of the world. Countries have been active and prolific at the bilateral and regional levels for some time – 432 RTAs have been notified to the WTO. But the key ongoing negotiations are of a different dimension: they involve more partners, from different levels of development and different regions, covering larger volumes of trade, and aiming at reaching agreements of a deeper nature on a wide scope of issues. These are the mega-regionals, of which the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership are in a category of their own by virtue of their scope and impact.

If current negotiations are successful, new rules will shape trade and investment flows, underpin global governance on 21st century trade issues and facilitate the proliferation of global value chains. Their purported emphasis on promoting broad liberalization, reducing non-tariff barriers and addressing regulatory hurdles through greater convergence would unleash new opportunities and bring about more growth to the world economy. They may also contribute to bringing more dynamism to the multilateral trading system, spearheading a virtuous circle of enhanced rule making and trade liberalization.

Or they may not. Much will depend on the specific provisions to be agreed upon and the type of preference they will create. Not all preferences are equal. Some of them carry a larger potential for discrimination than others. The greater their discriminatory nature, the higher the friction and fragmentation risks they entail. On the contrary, provisions with low or no discriminatory potential actually may be quite beneficial for non-members.

This is no minor issue. While mega-regional negotiations encompass a large number of countries, they exclude an even larger group. About 160 nations, home to over 80% of the world's population, are sitting on the sidelines while these discussions take place. The way in which countries choose to react to these developments may determine, at least in part, the impact of these pacts on individual non-members and on different regions, as well as on countries that are party to the mega-regionals. The broader question of the geopolitical impact that mega-regionals may have in today's world is an issue that demands great reflection.

The multilateral trading system is not exempt from the impact of mega-regionals. Much will depend on the specifics of the agreements that are finally concluded, and in particular on

whether they are crafted with an inclusive perspective and are open to new members. Much will also depend on whether WTO members opt to advance an ambitious post-Bali multilateral agenda, which could include plurilateral agreements as a way to proceed in consolidating the WTO's centrality.

All of this presumes that mega-regionals will come to fruition as planned, but this cannot be taken for granted. There are big negotiating challenges ahead, and domestic political divisions in participating countries to be bridged. If the mega-regionals fail, the consequences on the potential of trade and investment to continue driving world growth and prosperity will be considerable.

While there is a lot of uncertainty regarding the future and impact of mega-regional agreements, it is clear that this is the topic of choice in the global trade agenda today. This is why the World Economic Forum's Global Agenda Council on Trade & Foreign Direct Investment decided to dedicate its work this year to *Mega-regional Trade Agreements: Game-Changers or Costly Distractions for the World Trading System?*

Extensive discussions, with the participation of all Council Members, showed that this is a rich subject that poses important questions and ignites strong debates. A consensus was not reached on all its angles, nor was that the main purpose. Instead, the aim was to explore the impact that mega-regionals may have on non-members, highlighting opportunities and challenges in promoting the coexistence of these agreements – should they materialize – with the multilateral trading system.

The report benefited from the written contributions of many Council Members, to whom the Council is grateful. The Council also thanks Caroline Galvan for her support to the group. As Chair of the Council, I bear full responsibility for any mishaps in editing and putting these contributions together.

The report is organized into six sections:

- In section 2, Ricardo Meléndez-Ortiz sets the stage by presenting a set of criteria to define mega-regionals, while Peter Draper and Ricardo Meléndez-Ortiz describe the main features and potential impact on member countries of the ongoing TPP and TTIP negotiations.

- Section 3 presents two views regarding the rationale for mega-regionals, with Susan Schwab and Karan Bhatia exploring the offensive and defensive economic and commercial motivations that propel governments to pursue these negotiations, and Wang Yong focusing on the geopolitical reasons underlying the initiatives.
- In Section 4, two contributions analyse the impact of mega-regionals, with Ricardo Meléndez-Ortiz looking at the discriminatory and multilateralizing potential of TPP and TTIP provisions, and Richard Baldwin exploring the economic and systemic impact of mega-regionalism.
- Section 5 centres on the possible responses that mega-regionals may elicit from non-member countries, with Uri Dadush shedding light on the type of responses that may be pursued, and several GAC participants reflecting on the impact that mega-regionals may have in different parts of the world: Peter Draper and Salim Ismail looking at the consequences for sub-Saharan Africa and least-developed countries (LDCs); Sherry Stephenson, Jean-Pierre Lehmann and Wan Meng looking in individual pieces at the effects on Asia; and Beatriz Leycegui exploring the impact on Latin America.
- In section 6, Robert Lawrence proposes measures that could help ensure that mega-regional agreements complement rather than undermine the multilateral trading system.
- In section 7, Gary Hufbauer reflects on the consequences should mega-regionals fail to conclude.

With all the uncertainties and caveats surrounding the negotiation of mega-regional agreements, there is a strong case to be made on the importance of consciously working to facilitate the relationship between them and the multilateral trading system, for the benefit of all countries.

# 2. Setting the Stage

## 2.1. Mega-regionals: What Is Going on? – Ricardo Meléndez-Ortiz

For decades, but with particular impetus since the inception of the World Trade Organization in 1995, many of the WTO's members have enthusiastically embarked in selective associations with other members, aimed at more deeply integrating their economies. These schemes vary in nature, scope and effectiveness and range from free trade agreements to custom unions to common markets.

The General Agreement on Tariffs and Trade (GATT) defines free trade areas as those in which two or more custom territories agree to eliminate duties and other restrictions “on substantially all the trade” between them on products originating in their territories.<sup>1</sup> Colloquially and in WTO practice and law, such agreements are referred to as regional trade agreements (RTAs) to differentiate them from unilateral preferential schemes. By the end of 2013, 432 RTAs had been notified to the WTO, of which 238 were in force.<sup>2</sup>

In addition, countries have been prolific in establishing bilateral investment treaties containing rules and commitments that significantly affect trade in goods, services and technologies, as well as other terms of further integration of national economies into global markets. At last count, the world had in place 3,196 international investment agreements (IIAs): BITs and “other IIAs”.<sup>3</sup> Moreover, over 30 new RTAs, involving more than 110 countries, are currently under negotiation, with some of them geared to constitute a new order in international economic governance given their design, content and quantitative and qualitative weight in the global economy. Significantly, they involve all the important poles of trade and investment in the evolving global economy.

Several of these innovative agreements take place between two or more countries in different regions, or between countries with RTAs among them and individual countries or groups of countries in other RTAs. This type of composition is not unprecedented, but the trend is now affecting more parties and happens at a time when the Organisation for Economic Co-operation and Development (OECD) estimates that RTAs and IIAs already “cover among their member countries 90% and 60% of cross-border trade in goods and services, respectively”.<sup>4</sup> The last wave of agreements, in addition to establishing lower applied tariff rates between parties (with the collateral effect of generally lowering MFN applied rates), have also added a universe of contractual commitments among parties on provisions concerning mostly behind-the-border

regulatory matters that go deeper than their WTO obligations (WTO-plus) or that extend the coverage of WTO disciplines (WTO-beyond or WTO-extra obligations).

The economic significance of RTAs has also been in crescendo. RTAs of the past may have been defined more by geopolitics, but the new trend is for a greater emphasis on commercially meaningful associations that address several emerging policy concerns. Also, new RTAs are organized around a set of deeper integration issues that fosters transnational collaborative production and global value chains. They could be termed production-sharing RTAs or regulatory integration RTAs given their emphasis on an increasingly common and extensive package that in addition to market access includes services, competition policy, investment (including capital movement provisions), technical barriers and regulatory compatibility, intellectual property protection and customs cooperation. By their nature, at this time, trends in integration reflect three types of dominant RTAs:

- a. *FTAs of substantive current or potential trade and FDI value.* Examples under negotiation or recently concluded include US-South Korea; EU-Singapore; EU-Canada; EU-Japan; EU-India; EU-Mercosur; Australia-China; Canada-Korea; Canada-India; the embryonic CJK; and BITs between the US and China and the EU and China.
- b. *Consolidation RTAs*, in which existing RTAs are expanded through new membership or by merging with other RTAs. An example of a recent effort is the novel Pacific Alliance which practically fuses and further integrates six pre-existing FTAs among Mexico, Colombia, Peru and Chile, with possible extension to Costa Rica and Panama. The emphasis is on tariffs, services and cumulation of imports for rules of origin. Another example is the Tripartite Free Trade Area in Africa, aimed at consolidating three subregional agreements, i.e. the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA) and the Southern Africa Development Community (SADC).
- c. *Mega-regional RTAs*, deep integration partnerships in the form of RTAs between countries or regions with a major share of world trade and FDI and in which two or more of the parties are in a paramount driver position, or serve as hubs, in global value chains (i.e. the US, the EU, Japan, China). This category includes ongoing negotiations in the TPP; the emerging TTIP between the EU and the US; and potentially the RCEP, between the 10 ASEAN<sup>5</sup> countries and six of its RTA partners: China, India, Japan, South Korea, Australia and New Zealand. Beyond market access, emphasis in this integration is on the quest for regulatory compatibility and a rules basket aimed at ironing out differences in investment and business climates.

This report's focus is on this last category, and on the TPP and the TTIP in particular. They are singled out given their conformity with criteria that profiles them as a potential new pillar of trade governance<sup>6</sup>, complementary to the multilateral trade system:

- a. The agreement would affect a share of at least a quarter of world trade in goods and services (TPP: 26.3%; TTIP: 43.6%)<sup>7</sup> and of global FDI.
- b. At least two economies party to the agreement are hubs in GVCs as evidenced by their share of trade intermediate goods and tasks in the region or regions involved.<sup>8</sup>
- c. The agreement's coverage goes deeper and beyond existing – 2013 – contractual obligations and disciplines of the WTO, RTAs and BITs. In this context, the agreement addresses a minimum of areas and regulatory reform essential to 21st century world markets such as services, investment, competition policy, regulatory convergence, the digital economy and customs cooperation.
- d. Parties to the agreement are engaged in multiple RTAs with third-party economies and enjoy extensive trade and investment exchange with a significant number of non-members, making the partnership a potential reverse trade-diversion scheme.<sup>9</sup>

## 2.2 The Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP) – Key Issues and Potential Impact on Members – Peter Draper and Ricardo Meléndez-Ortiz<sup>10</sup>

### 2.2.1 TPP

The TPP encompasses a number of East Asian and North and South American countries. In 2006, Brunei, Chile, New Zealand and Singapore initiated a four-way FTA, termed the Pacific-4, with a vision of comprehensive trade liberalization being implemented by 2015. By 2010, an additional five countries, the United States, Australia, Malaysia, Peru and Vietnam, signalled their intention to join the agreement, leading to the creation of the TPP. Since then, Mexico, Canada, Japan and South Korea have requested to join the TPP, and during 2013, existing members approved participation of the first three candidates in the expanded TPP (often referred to as the TPP-12).<sup>11</sup> By mid-March 2014, South Korea completed the first round of bilateral consultations with each of the 12 parties. However, at this

stage, no additional member would be expected to join before an agreement is first finalized by the TPP-12.<sup>12</sup>

The TPP aims to achieve extensive liberalization of both goods and services, and entails comprehensive coverage of trade in services, investment, government procurement, non-tariff measures and many regulatory topics, as indicated in Box 1. However, as highlighted by the Congressional Research Service, the 12 countries are economically and demographically diverse. The US is more than twice as large as any other TPP country in terms of its economy and population; there is wide variation in levels of economic development between member states, and each has significantly different strategic and economic interests.<sup>13</sup>

### Box 1 – The Content of TPP

The following topics are reported to be included in the ongoing TPP negotiations:

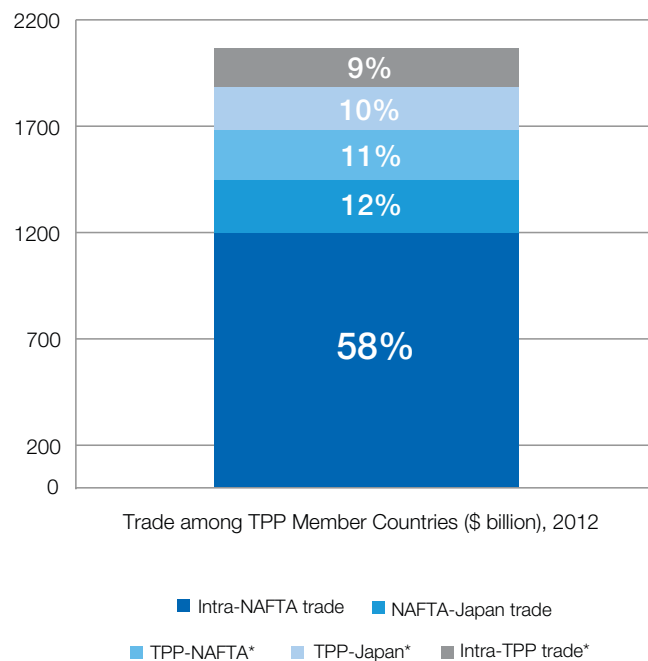
- **Market access for agricultural and industrial products.** Parties aim for duty-free access for trade in goods. They are also dealing with export and import licensing procedures, customs issues and trade facilitation.
- **Services.** The agreement would employ a negative list approach and cover financial services, including insurance and insurance-related services, banking and related services, as well as auxiliary services of a financial nature, to be addressed in a separate chapter.
- **Government procurement.** Agreement states common principles and procedures, as well as specific obligations for conduct of procurement; it aims at comparable coverage by all members, while recognizing transitional measures for procurement markets of developing countries.
- **Agriculture, other than market access.** It will deal with sanitary and phytosanitary standards (SPS); tobacco regulation; and agricultural competition.
- **Rules.** The TPP will include chapters and provisions that build on disciplines contained in the WTO's Uruguay Round agreements on Technical Barriers to Trade (TBT) and intellectual property rights (IPR) enforcement. For example, the TPP TBT text introduces provisions that would remove restrictions for testing, inspection and certification of services providers, such as in-country presence requirements. On IP, it would agree to a shared commitment to the Doha Declaration on TRIPs and Public Health and include innovative provisions, particularly on (i) Patents (e.g. available for plants and animals and for diagnostic, therapeutic and surgical methods for the treatment of humans and animals and adjustment of the duration of patents to compensate for delays occur in the granting process); (ii) Undisclosed data (e.g. exclusive protection for five years of the pharmaceutical safety and efficacy information, from the date of marketing approval, in the territory of a party including similar protection for safety and efficacy of a product previously approved in another territory; further protection for at least three years on new clinical information for the approval of a pharmaceutical product containing a previously approved chemical entity including those previously approved in another territory); (iii) Copyright (e.g. term

of protection in the case of juridical persons of 90-120 years compared to the standard of 70 years in TRIPS; improved legal remedies against the circumvention of effective technological measures); and (iv) Enforcement measures (e.g. expansion of existing standards in TRIPS, ACTA and KORUS on civil and administrative procedures, including provisional and border measures and criminal procedures and penalties, namely, in cases of trademark counterfeiting and copyright or related rights piracy and misappropriation of trade secrets and a section on internet service providers). TPP would also include provisions on biologics and transparency and procedural fairness in healthcare technologies.

- **Rules of Origin:** Cumulation of origin. Since many of the parties to the TPP are trading partners in FTAs, being part of the TPP implies that inputs originating from a TPP country that are included in a final good exported by another TPP nation to a third TPP member are regarded as originating in such nation. This fosters the participation of TPP members in regional production networks.
- **Investment:** Provisions of investment protection, ensuring non-discrimination, a minimum standard of treatment, rules on expropriation and prohibitions on specified trade distortive performance requirements. Also, provisions for investor-state dispute settlement subject to safeguards to protect the rights of TPP countries to regulate in the public interest.
- **Competition Policies:** Establishment and maintenance of competition laws and authorities, procedural fairness in competition law enforcement, transparency, consumer protection, private rights of action and technical cooperation.
- **Trade Remedies**
- **Separate chapters on labour and environment.** On the latter, it may contain substantive provisions on new issues, such as marine fisheries and other conservation issues, biodiversity, invasive alien species, climate change, and environmental goods and services, in addition to cooperation for capacity building.
- Other new and cross-cutting issues will include regulatory coherence; state-owned enterprises; e-commerce; competitiveness and supply chains; and small and medium-sized enterprises.

Given the significant economic diversity of member states in terms of wealth, production structures and strategic goods, the TPP's wide coverage requires extensive negotiations between member states in order to achieve the goal of a significant and far-reaching agreement. In addition, the goods sector is being negotiated based on the existence of current bilateral FTAs. Thus, where FTAs exist between countries, they are likely to be adopted within the TPP, while countries without an existing FTA between them have entered into negotiations on a bilateral basis.<sup>14</sup> Meanwhile, other issues are being negotiated among all participants; yet, the goal remains a single agreement applicable to all members. This complexity has some implications for the eventual outcome, and is discussed further below.

**Figure 1.** Trade among TPP Member Countries (\$ billion), 2012



\* Excludes USA and Japan

Source: Draper et al., P10-11.

The TPP can significantly impact on global trade dynamics, given that goods trade among TPP partners amounted to more than \$2 trillion in 2012 (see Figure 1). The North American Free Trade Agreement (NAFTA) (Canada, Mexico and the US) and Japan nevertheless accounts for the largest proportion of this trade, with intra-NAFTA trade alone amounting to nearly \$1.2 trillion in 2012. Bilateral trade between Japan and NAFTA accounted for close to \$250 billion (over 80% of which was between the US and Japan) of total intra-TPP trade, with Japanese exports to NAFTA countries accounting for \$160 billion.

Trade flows between the remaining TPP-12 members made up only \$180 billion of total TPP trade. Trade between the remaining TPP-12 members and NAFTA, and between the rest of the TPP-12 and Japan amounted to \$233 billion and \$204 billion respectively.<sup>15</sup> Clearly, the NAFTA countries, particularly the US, and Japan are the key drivers of the TPP. Indeed, the US and Japan, in line with what has been suggested by Baldwin (2014) and with evidence generated by estimating shares of trade in intermediate goods and services for the US and Japan and partners in the TPP and other economies in the Pacific basin, drive supply and transnational organization of production and serve as regional hubs.<sup>16</sup>

The large number of FTAs being implemented between Asian and Pacific states also suggests that the effects of tariff liberalization may be low despite the significant share of global trade accounted for in this region. Cheong (2013) underlines the extent to which FTAs may dilute the effect of liberalization on goods trade, with countries in the Asia-Pacific region having signed close to 100 FTAs (either bilateral or regional) between themselves. Cheong (2013) further notes that many previous studies estimating the effects of regional FTAs in the region may have therefore over-estimated the gross domestic

product (GDP) and trade gains likely to be achieved through greater regional integration in this region by not taking into account that goods trade is already significantly liberalized through the numerous FTAs already being implemented.<sup>17</sup> In terms of goods trade, the TPP faces a similar situation, with many countries within the TPP already trading under free trade arrangements.

Cheong (2013) suggests that the gains for member states from goods trade liberalization through the TPP are likely to be negligible for most member countries. All countries, with the exception of the US, Chile and Peru, are likely to experience a marginal increase in their GDP. However, for all members, this increase is less than 1%, with New Zealand experiencing the greatest gain (0.97%) and Canada the lowest (0.02%). Conversely, the results suggest that the US is unlikely to experience any change, while Chile and Peru are likely to experience negligible GDP declines of 0.13% and 0.04% respectively.<sup>18</sup>

Estimates from the Peterson Institute for International Economics suggest the potential impact of the TPP may be somewhat larger, when including the impact of reducing non-tariff measures.<sup>19</sup> The model assumes a staggered approach to the implementation of the TPP, with an agreement among the nine original members by 2013 and the three additional members (plus South Korea<sup>20</sup>) one year later. Enforcement occurs one year after the agreement is signed, followed by five years of implementation. The study finds that by 2025, real GDP will increase by 0.75% for TPP members. The potential impact on individual countries ranges from a positive 0.4% impact on GDP for the US to a 13.6% improvement in GDP for Vietnam. Similarly, exports could increase significantly, from 2.5% for Chile to 37% for Vietnam. Vietnam's gains are expected to arise through its expanded role as a manufacturing centre of textile and garment industries.

Cheong (2013) and Williams (2013) both note that many see the TPP as a stepping stone to the creation of a free trade agreement among all APEC members, given that TPP members form a sub-set of APEC. As Williams (2013) highlights, TPP country trade with the other APEC members not currently party to the TPP negotiations is larger than intra-TPP trade, amounting to over \$2.7 trillion in 2012, with China accounting for over 50% of this trade. The creation of an APEC free trade area (also known as the Free Trade Area of the Asia-Pacific) would be the largest single market on the planet, bringing significant gains to member states. Petri and Plummer (2012) estimate that these gains could amount to an additional \$2 trillion (2007 dollars) by 2025, or an increase in APEC GDP by 3.5%. The long-term gains from the TPP for member states may therefore be substantially greater if this agreement creates a domino effect where all other APEC members subsequently "fall" into the TPP.

## 2.2.2 TTIP

The TTIP negotiations, launched in June 2013, aim for a far-reaching trade agreement between the US and the EU, focusing on trade liberalization, behind-the-border and other non-tariff barriers as well as seeking a "high standards" approach to alignment, compatibility and possible harmonization of regulations and standards governing the goods, services, investment and public procurement markets, as shown in Box 2.<sup>21</sup>

## Box 2 – The Content of TTIP

TTIP negotiations are organized in three baskets, each encompassing the following set of issues:

### a. Market Access

- Removal of all duties in industrial and agricultural products, with special treatment for the most sensitive products
- Rules of origin
- Trade in services, which seeks liberalization in new sectors, e.g. transport, excluding audio-visual services.

### b. Regulations and Non-Tariff Barriers

Parties aim at regulation system compatibility and alignment, to be achieved by a combination of simplification and harmonization of procedures for compliance and regulation-making, and the establishment of a standing scheme for regulatory cooperation towards the future. Such a scheme would built on the existing High Level Regulatory Cooperation Forum (HLRCF) and involve regulators, the regulated community, technical experts and other stakeholders. An innovation will seek a common framework approach on emerging technologies, namely, e-mobility, nanotechnology and smart grid, and eventually health IT and cybersecurity.

### c. Rules

- Trade defence measures to establish a systematic dialogue on anti-dumping and countervailing duties
- Investment, with guarantees of protection against expropriation, free transfer of funds, fair and equitable treatment and a level playing field for investing companies, investment protection, including investor-to-state dispute settlement, relevant safeguards and right to regulate
- Public procurement
- Financial regulation rules
- Intellectual property rights, including geographical indications – reportedly aiming at further promoting robust IP frameworks and effective levels of enforcement with emphasis on the digital environment and attempts to reconcile their respective regimes on geographical indications and data flows
- Labour and the environment – innovation includes illegal logging and illegal, unreported and unregulated fishing (IUU)

In addition to the above, the agreement would include new "21st century" issues, e.g. modernization and simplification of trade-related aspects of customs and trade facilitation; competition policy; state-owned enterprises; raw materials and energy; small and medium-sized enterprises; forced localization of production; and transparency.

MFN tariff regimes in the EU and the US are comparatively low, as noted by Ecorys (2009), Rollo et al. (2013) and Fontagne et al. (2013). Fontagne et al. (2013) estimate that the average tariff protection on EU goods imported by the US amounts to only 2.2%, while US goods imported by the EU attract an average tariff duty of 3.3% in ad valorem equivalent terms.<sup>22</sup> It is clear that tariff liberalization, while forming an important component of TTIP negotiations, is unlikely to achieve significant economic gains for either the



US or the EU, with the exception of the removal of duties on a comparatively small number of sensitive products.

More significant gains are likely to be made through the elimination of non-tariff measures and ex-ante and ex-post compatibility and alignment of standards regulation and systems that act as barriers to trade, investment and public procurement. Many of the non-tariff impediments and frictions cannot be completely removed (such as geographic, cultural and language barriers) and both the US and the EU recognize that there are legitimate philosophical, structural, institutional and legal differences that have resulted in different approaches to risk and regulation across the Atlantic.

Still, any progress on compatibility of regulation, through harmonization or mutual recognition of technical standards, facilitation of conformity assessments, pre-market or post-market oversight, or addressing market access impediments to providers of testing, inspection and certification services, can bring about significant reductions in the costs of trade and investment in both markets and for third-party providers. Compared to low tariff barriers, Ecorys (2009) and Fontagne et al. (2013) estimate that bilateral ad valorem equivalent protection between the US and the EU from non-tariff measures was significantly higher and ranged between 19% and 73% across the agriculture, manufacturing and service sectors. Ecorys (2009) estimated that roughly 50% of non-tariff measures and regulatory differences between the US and the EU could be eliminated.

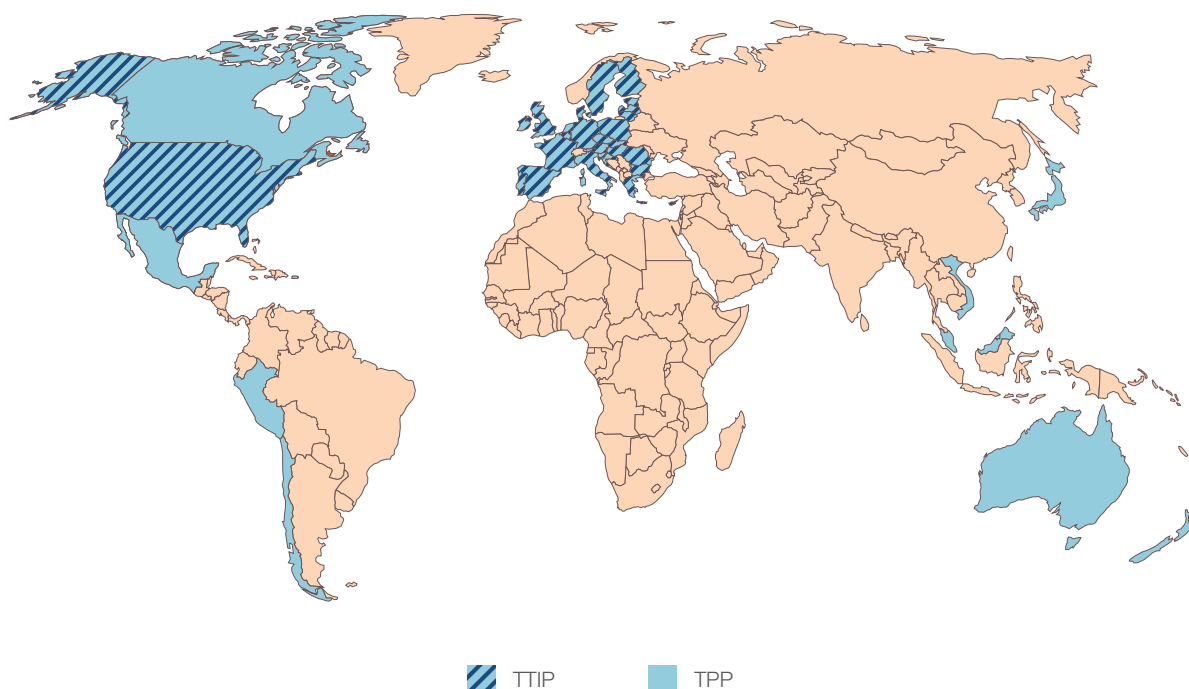
The potential impact of the TTIP on the US and the EU has been evaluated by a number of studies. The earlier Ecorys (2009) study suggests that the reduction of non-tariff measures would produce modest improvements in national income and real wages for the US and the EU, while changes to total exports could be more substantial. In an “ambitious” scenario, where 50% of non-tariff measures and regulatory divergence are eliminated, real income could increase by 0.3% and 0.7% in the long run for the US and the EU respectively. In a “limited” scenario (where 25% of non-tariff measures and regulatory divergence is eliminated),

real income in the long term could increase by 0.1% for the US and by 0.3% for the EU. In the long term, total exports by the US could increase by 6.1% and 2.7% in the ambitious and limited scenarios, while EU exports could increase by 2.1% and 0.9% respectively. More recently, a study commissioned by the EU, effectively updating and using a similar methodology to that of Ecorys (2009), produced similarly modest results.<sup>23</sup>

Fontagne et al. (2013), using a different computable general equilibrium modelling technique and an alternative estimation of non-tariff measures, finds that a 25% reduction in non-tariff measures coupled with a full reduction in tariff duties could produce a 0.3% increase in the GDP of both the EU and the US over the long run. The volume of total exports could increase more significantly in the long run, by roughly 10% for the US and by approximately 8% for extra-EU exports.<sup>24</sup> In contrast to these studies, Felbermeyer et al. (2013) use for the Bertelsmann Institute a gravitational econometric model approach to estimate the size of protection from non-tariff measures. They find that the implementation of the TTIP may produce substantially larger economic gains.<sup>25</sup> They find that tariff liberalization could result in a real per capita income increase of 0.27% for the EU (unweighted mean) and 0.8% for the US. The impact is much larger under a deep liberalization scenario, with the full reduction of non-tariff measures. Under this scenario, real per capita income increases by 13% for the US and 5% for the EU. However, the vast difference in estimated impacts between this study and those noted previously (including the study commissioned by the EU) has resulted in the EU suggesting that the Bertelsmann Institute’s study is based on an untested methodology “that departs from the standard approach used so far in other similar studies” and that some of the results produced are “unreasonable and inconsistent” and “unrealistically high”.<sup>26</sup>

Regardless of one’s view on modelling techniques and associated results, it is clear that a reduction of non-tariff measures and regulatory differences will play a much more significant role in unlocking economic gains for both the US and the EU than a reduction in traditional tariff duties.

**Figure 2: TTIP and TPP membership**



# 3. The Rationale behind Mega-regionals – Two Views

## 3.1. Why Mega-regionals? – Susan Schwab and Karan Bhatia

The motivation behind any given mega-regional depends on the nature of the agreement being negotiated, on the particular countries involved, and often on the point in time the decision is being made to engage or close the deal. Often, the decision to launch a mega-regional agreement is informed by geopolitical considerations. However, the ultimate success of the negotiation and the long-term viability of the arrangement turn more on economic and commercial considerations. This is true, for example, with the European single market – arguably the original mega-regional. While geopolitical considerations were at the heart of its formation, economic considerations now lead as its principal impetus. In the case of NAFTA, the original rationale might have been briefly geopolitical, but rapidly became more commercial as the negotiations were launched and progressed.

Indeed, the economic calculus is increasingly critical to a country's decision whether to join a mega-regional. In an era when most trade issues that are easy to negotiate were disposed of during the first eight multilateral rounds under the GATT or in early bilateral free trade arrangements, the items left to be negotiated tend to be new or the more difficult ones left over from earlier negotiations. Therefore, for most serious trade agreement negotiations today to succeed – and this is certainly the case with mega-regionals – strong economic and commercial motivation on the part of all parties is the real prerequisite. While geopolitical motives may inform a decision to launch mega-regionals and other serious trade agreements, they are not sufficient to conclude or implement them.

So, what are the economic and commercial motivations that propel governments to pursue mega-regionals? They can be both offensive and defensive in nature.

### Affirmative/Offensive reasons

The last major market access agreement under the auspices of the GATT/WTO was the Uruguay Round, which concluded two decades ago. The WTO's last significant market opening agreement was the Information Technology Agreement in 1996. The trade facilitation agreement concluded at the

December 2013 WTO Ministerial could prove important – depending on implementation. Beyond that, countries interested in trade liberalization have largely had to rely on their own initiative. Traditional neomercantilist motives, the search for growth markets, the use of trade agreements to self-impose domestic economic reforms, diversification of markets and risk, economies of scale, the enhancement of competitiveness, export-led growth, and the building of global supply chains are all examples of public and private sector motives for using trade agreements to expand access to international markets. As the WTO stalled as a venue for trade-liberalizing negotiations, the vehicle for achieving these goals has increasingly shifted to bilateral and regional agreements. In particular:

*Improved and/or preferential access to new markets.* The most obvious reason for pursuing trade agreements is to achieve improved market access for exports of goods and services and foreign direct investment. Even after eight rounds of multilateral agreements under the auspices of the GATT/WTO, there remain tariff peaks, border measures and behind-the-border measures that, if eliminated or reduced, can provide a beneficiary country's exporters with improved and potentially preferential access. In the case of the TPP, all participants would come away with improved access to at least one new country market, and in some cases, several new markets. To the extent that enhanced access arrangements are limited to a finite number of countries or exclude a country's principal competitors, the trade agreement also provides a measure of preferential access. For some countries involved in the TPP negotiations, like Vietnam and Malaysia, enhanced access to the US market is an attraction; for the US, access to the Japanese market in particular could be interesting. RCEP's origins in ASEAN+1 negotiations, and initiatives involving ASEAN+3 and then ASEAN+6, were heavily influenced by market access motivations.

*Economic stimulus in an era of tight budgets.* This was one of the principal motivators behind the TTIP – an opportunity to give an economic boost to industries on both sides of the Atlantic at a point when both the US and the EU economies were in the doldrums and neither side could indulge in heavy financial stimulus packages or had additional room for monetary stimulus. While low tariffs already apply on trans-Atlantic trade and significant FDI already exists, removing basic barriers at the border and eliminating regulatory friction promises to leave billions of dollars/euros in the pockets of small, medium-sized and large importing and exporting enterprises.

*Upgrading, refreshing, building out “old” agreements.* The TPP was launched when the “P4” – Brunei, Chile, New Zealand and Singapore – approached the US about joining their goods-only agreement. For them, it was an opportunity to grow and expand the scope of an existing negotiation and gain critical mass. When the US initially raised the opportunity with Canada and Mexico, it was to update and upgrade their older free trade agreement, NAFTA.

*Achieving higher ambition agreements.* With the WTO seemingly stymied by a governance structure that enables a handful of members to impede consensus and block all but the lowest common denominator outcomes, mega-regionals – together with bilateral free trade agreements and sectoral and other forms of plurilateral agreements – provide the opportunity for like-minded countries to work together to achieve higher order agreements. These may involve provisions that deliver more market access than their WTO counterparts by cutting tariffs further or offering more generous non-tariff concessions or putting in place more practical rules of origin.

*Addressing new issues and creating potential precedents for future multilateral agreements.* This clearly informed the US decision to join the P4, an otherwise modest agreement. With the slow pace of WTO negotiations, the rules-based multilateral trading system has fallen woefully behind the reality of global trade and emerging protectionist practices. The longer a given set of trade-distorting practices has to get entrenched, the greater the challenge of creating disciplines to address them later. Issues related to e-commerce, forced localization, data privacy, competition policy, levelling the playing field between state-owned and private enterprises are all examples of topics under consideration in various mega-regionals, with a view to finding potential formulations that might eventually be adopted by a broader WTO membership.

*Improving competitiveness.* In the case of TTIP, there has been an explicit desire to use a trans-Atlantic agreement to leverage an enhanced competitive outcome for industries on both sides of the ocean. The stated goal of achieving some measure of regulatory convergence is consistent with traditional trade agreement desires to enhance economies of scale, but in this case with the added implications for competing with standards being developed elsewhere. There is also a tradition of using trade agreements and the promise of new market access opportunities as a means to leverage sometimes difficult domestic economic policy reforms. In the case of both the TPP and the TTIP, various government leaders are on record expressing an interest in using the agreements to this end.

*Keeping the bicycle moving forward.* Trade mavens who share the values of open markets, open trade and open institutions are fundamental believers in momentum, and the absence of progress on the multilateral front until late 2013 left a painful vacuum. Chile responded by negotiating dozens of bilateral free trade agreements, the P4 and more recently the Pacific Alliance, along with Colombia, Mexico, Peru and Costa Rica. Looking at the 20+ country observer list, the Pacific Alliance may be the next mega-regional to succeed.

In this regard, it is worth noting that these affirmative motivations appear to have little to do with the level of development or size of an economy, since the countries involved in mega-regional negotiations to date come in all varieties. Instead, they appear to have as much to do with economic philosophies, leadership and national priorities as any other identifiable factor. And it is premature to know what characteristics may or may not correlate with success.

### Defensive reasons

Some might argue that defensive reasons are at the heart of several mega-regional initiatives today. While commercially viable and economically valuable trade agreements are too difficult to negotiate to be concluded on the basis of defensive fuel alone, clearly defensive reasons do inform some countries’ decisions to engage and may ultimately slow down or even bring down the higher ambition results sought by others.

*Fear of being locked out.* Behind the concept of “competitive liberalization” is the notion that countries will ultimately cooperate in trade-liberalizing negotiations when they see negotiations going on around them that create the risk they will ultimately find themselves on the outside at a competitive disadvantage. In fact, one of the original motives for the US to agree to launching the TPP with the P4 in September 2008 was concern about being locked out of an ASEAN+3 agreement, whose negotiation was already underway. For New Zealand, the TPP was an opportunity to address the challenge of having two main markets and allies – Australia and the US – share an FTA with each other.

*Protecting existing preferential trade arrangements.* For Canada and Mexico, whether updating and upgrading NAFTA was a main motivator to join the TPP, not letting the benefits from the new agreement erode the benefits of the old probably was more important. Interestingly, with the proliferation of bilateral, regional and plurilateral agreements, erosion of preferences generated by bilateral trade agreements is more commonplace – making some of the newer, more innovative provisions of plurilateral and mega-regional agreements that much more interesting. It is also worth noting that some important issues that remain – such as involving subsidies and other rules – often only lend themselves to multilateral solutions.

*Easier to help write rules now than to accede to them later.* This motivation is a variation on the fear of being locked out, but relates more to rules – particularly the newer ones – than to market access. Like all of the defensive motivators, once a country is inside the negotiation, it can as easily be satisfied by slowing down or dumbing down the negotiation as by acting as a constructive participant.

### Conclusion

Even though the jury is out on when and whether the mega-regionals currently under negotiation will conclude successfully, absent a reinvigorated agenda at the WTO, mega-regionals and other forms of plurilaterals may be the inevitable direction taken by likeminded countries in a globalized world. They provide a means for facilitating existing patterns of commerce and building new ones. They

enable businesses and governments to respond proactively to competitive challenges and create higher common denominator trade agreements. And if designed with open architecture, they hold open the option of building out eventually to a healthier multilateral outcome.

## 3.2 The Political Economy of the Rise of Mega-regionals – Wang Yong

Several key reasons account for the rise of mega-regionals, according to the discussions among scholars and experts.

*RTAs have become an important trend since the mid-1990s, as a parallel development accompanying the strengthening of the WTO authority.* Since the mid-1990s, while a WTO with more “teeth” than the GATT was established, NAFTA and many other PTAs have caught the attention of the world. NAFTA symbolized the great changes in the US approach towards regionalism, and these changes prompted the wave of so-called “new regionalism” (UNCTAD, 2007). For example, the EU entered into different forms of FTAs with developing countries and transition economies (UNCTAD, 2007). Since the Asian financial crisis of 1997-1998, the major economies in East Asia, ASEAN, China, Japan and South Korea worked to catch up with this new wave of regionalization. As a result, more RTAs were signed, and more developed and developing countries became involved. These arrangements do not limit themselves to reducing border barriers, but also include “deep integration” measures engaging partners in opening up the areas of services, energy, industrial policy, and so on. The rise of the TPP and the TTIP can be perceived as the continuation of the regional cooperation trend that began by the mid-1990s, with the US and the EU as the driving economies.

*Lack of agreement on the Doha negotiations reinforced the perception of inefficiency of policy-making at the multilateral trading system.* There are a number of factors that explain this, including: the increasing number of new WTO members, which makes it more difficult to coordinate and compromise; the global financial crisis of 2008, which has put the Doha negotiations in a more challenging – and protectionist – context; the lack of support from the business community in developed countries; the different views among developed and emerging economies on the balance of concessions to be made and results to be achieved; the dichotomy among emerging economies themselves; and the restructuring of the negotiating powers, with emerging economies like Brazil, India and China exercising more influence but at the same time being reluctant to make market access concessions to meet the demands of some developed countries.

*Geopolitics also contribute in part to the rise of mega-regionals.* The decade following the events of 11 September 2001 witnessed a transition period in world politics. The US experienced relative decline after it reached its peak of influence in the late 1990s, while at the same time emerging economies accelerated growth and began to rise. Although Washington policy circles tend to deny US geopolitical considerations in engaging in TPP negotiations, more people believe the US is concerned about the loss of power and

influence in Asia, possibly caused by the rise of China-centred cooperation in the region. In this context, the Obama administration announced its pivot to Asia shortly after it came to power (Wang, 2013).<sup>27</sup>

US proponents of the TPP see it as a way of thwarting the emergence of a China-centred East Asia economic bloc. The US also sees the TPP as a useful way of constraining the centrifugal tendencies of its allies Japan, South Korea and Australia, which are attracted by China’s growing economic power. With China now their largest trading partner, the future prosperity of all three will depend more and more on the Chinese market. Closer economic interdependence has also encouraged US allies and friends in East Asia to pursue more ambitious blueprints for regional cooperation that exclude the US. In this light, it is understandable that the US is eagerly seeking the full participation of Japan in the TPP talks, as together, the US and Japan would account for about 90% of the total GDP of all TPP members. Japanese involvement would also help tighten the security alliance between the US and Japan, and would likely bring along South Korea (Wang, 2013).

Recently, Taiwan, China has sought to join the TPP, and the US government is reported to have extended a positive welcome (Bush, 2013). For some, if Taiwan, China were to join the TPP, it could be a good policy tool to check the rising influence of China in Taiwan, China.

*Mega-regionals aim to meet the liberalization needs of developed members of the WTO.* By adopting high standard deals, developed economies can tap the potential of trade and investment constrained by the existing rules and regulations imposed by the WTO and bilateral arrangements. According to one study, if the TTIP is realized, the US and the EU will greatly benefit from deeper integration arrangements. The Centre for Economic Policy Research in the United Kingdom estimates that 80% of the potential economic gains from the TTIP agreement depend on reducing regulatory discrepancies derived from EU and US rules on issues ranging from food safety to automobile parts, including increasing market access to each other in pharmaceuticals, agricultural products and financial services (Bollyky and Bradford, 2013).

According to the Centre for Economic Policy Research, a comprehensive agreement will result in annual GDP growth in the EU of 68 billion to 119 billion euros by 2027 and annual GDP growth of 50 billion to 95 billion euros in the US. A limited agreement focusing only on tariffs would result in annual GDP growth in the EU of 24 billion euros by 2027 and annual growth of 9 billion euros in the US. The maximum GDP growth estimates could possibly translate into additional annual disposable income of 545 euros for a family of four in the EU and 655 euros for a family of four in the US (Francois et al., 2013).

*Mega-regionals symbolize the will and determination of the US and the EU to keep a decisive say on the rules applicable to trade and investment in the 21st century.* Many analysts point out that the TTIP and TPP will ensure that the US and Europe remain “standard makers, rather than standard takers” in the global economy, subsequently ensuring that

producers worldwide continue to gravitate towards joint US-EU standards, and that they would set the international “rules of the road” (Bollyky and Bradford, 2013; Kaeser, 2014).

For years, the US and the EU, as the most important players in the multilateral trading system, exercised the final influence in negotiations over trade rules, as was the case in the Uruguay Round, whose results mainly reflected the interests of the US and other developed nations. When the Doha Round was launched in 2001, however, developing nations pointed out that developed countries had not yet fully implemented their existing WTO obligations to open their markets, and therefore insisted that the Doha Round focus on development issues. Since then, the deadline for concluding the Doha Round has been postponed several times, and the US has accused emerging economies such as China, India and Brazil of creating a deadlock in the negotiations because they will not make more market-opening concessions.

Learning from its experience in using the APEC forum to pressure the EU for concessions during the Uruguay Round, the US has deliberately adopted a radical approach to trade negotiations in Asia, entering into bilateral FTAs and the TPP. The US government is now aiming to shape future trade rules by focusing TPP talks on topics such as the environment, protection of labour rights and the role of state-owned companies. Not surprisingly, this time the US and the EU have found more common ground on these issues and on dealing with competition from emerging economies, which are challenging their domination of trade rule-making authority. It is within this broader context that President Obama announced in his State of the Union address in 2013 the start of the TTIP with the EU, an initiative that has been warmly received by the EU. Both the TPP and the TTIP follow the same logic, and they provide a way for the US to have a decisive say over the trade rules of the 21st century (Wang, 2013).

Furthermore, the TPP and TTIP also represent something of an ideological or soft power contest between the US and China. In the aftermath of the global financial crisis, some observers hailed the “China model” as an important guide to finding a post-crisis development model for the world, especially for developing countries. The US, for its part, has been critical of China’s so-called state capitalism, where state-owned enterprises play a large role in the economy. Both arrangements will include a strict standard to limit the role of state-owned enterprises in trade and economy (Wang, 2013).

## Conclusion

The launch of mega-regional FTAs, especially the TPP and TTIP, has caused wide concerns. Developing countries are worried that they will be left outside the mainstream of the global economy. As some analysts argue, the global economy may be fragmented and break into two separate blocs (Aggarwal and Evenett, 2013). To deal with the potential trade-diverting effects of the TPP and TTIP, some developing countries have begun to build their FTA arrangements. Mega-regionals could trigger fierce competition among different trading blocs and damage the reputation and authority of multilateral trading. More seriously, if the US implements the TPP in tandem with a significant redeployment of US military forces in the Asia-Pacific region, it could create tensions

reminiscent of the Cold War in Asia. Only this time, because so many are benefiting from their economic ties with China, Asian countries will be reluctant to take sides between the US and China.

A positive development lies in the early harvest deal struck in the Bali WTO ministerial meeting in December 2013. This package, which narrows the gap between the developing and developed members, helped save the WTO from marginalization. Some analysts argued that this is the latest example of the rising power of developing members in the WTO (Zhang, 2014), but others may contend that the US and the EU sought to improve their image tarnished by pushing ahead with mega-regional arrangements. This deal allows developing economies to relax about the future of the multilateral trading system, and succeeds in creating an easier and amicable atmosphere for the TPP and TTIP negotiations.

# 4. The Impact of Mega-regionals

## 4.1. Discriminatory and Multilateralizing Potential of TPP and TTIP Provisions – Ricardo Meléndez-Ortiz

In evaluating the impact of RTAs on non-members, the discussion normally centres on their potentially discriminatory effects. In the case of the TPP and TTIP, though negotiations have not concluded yet, it is possible to get a sense of their potential impact by looking at the nature of their provisions. For this purpose, issues were divided between WTO-plus and WTO-extra and then assessed based on two criteria: the potential risk for discrimination against outsiders (making a distinction between de jure discrimination and de facto discrimination); and the potential for “multilateralization”, roughly based on the criteria developed by the OECD.

Such potential for multilateralization is reflected as much by the intrinsic characteristic of the provisions or chapters in an agreement as by their relative impact beyond the economies involved. Parameters to take into account in assessing this potential for each provision or chapter would include *representativeness* (whether a provision is common to a considerable number of RTAs already, and use in agreements involving countries at different levels of development); *homogeneity* (the similarity between the provision across RTAs); and, *enforceability* (whether the provision is contractual and, furthermore, whether it may be enforceable through WTO dispute settlement).

The results are presented in Table 1. The assessment under criteria 1 and 2 for each type of provision is based on limited information on the detailed outcome of negotiations and best judgement by analysts at the International Centre for Trade and Sustainable Development (ICTSD) and not on any scientific method or research. Provisions where limited risk of discrimination exists and with high potential for multilateralization should be encouraged from a global governance perspective.<sup>28</sup>

## 4.2. The Economic Impact – Richard Baldwin

Mega-regionals should not be thought of as big free trade agreements. In the terms of Lawrence (1996), mega-regionals are “deep” agreements; FTAs are “shallow” agreements. That is, free trade agreements are mostly about tariffs, while mega-regionals cover a vast spectrum of deeper-than-tariff measures. Of course, mega-regionals will change some tariffs, but most of the provisions go much deeper into writing rules that underpin global value chains.

The hard edge of the shallow versus deep distinction is the type of preference that is created. Preferential tariff-cutting inevitably creates discrimination against third nations. Deeper-than-tariff reforms have more subtle effects. Three categories can be distinguished:

- Hard preferences, i.e. preferences imply discrimination
- Soft preferences, i.e. preferences that lack discrimination technology
- Non-preferences, i.e. reforms that act like multilateral liberalization

Consider some examples.

### Hard preferences, soft preferences and non-preferences

The US tariff on men’s polyester cotton shirt is 25.9%. If the TPP lowers this to zero for Vietnam but not for China, Vietnam-based firms will win – in part at the expense of Chinese-based firms. This is a “hard preference” – the preference implies discrimination. The gain for Vietnam is trade creation; the loss to China is trade diversion. This 20th century thinking is only part of the story when it comes to mega-regionals.

Mega-regionals like the TPP and TTIP will create some new tariff discrimination, but not much. Tariffs currently applied among mega-regional members are already very low, and where they are still high they cover only modest amounts of trade and, in any case, are likely to be excluded from the final deal for political reasons. Tariffs on Japanese rice or US dairy are unlikely to be eliminated by the TPP.

**Table 1:** Potential for Discrimination and/or Multilateralization of selected possible provisions in TPP and TTIP

Type of Provisions		Potential for Discrimination against Outsiders (H = high; M = medium; L = low; N = negative discrimination)				Potential for Multilateralization (H = high; M = medium; L = low)	
		TPP		TTIP		TPP	TTIP
		De jure	De facto	De jure	De facto		
WTO plus (+)	Industrial tariffs	H	M*	H	M*	L	L
	Agricultural tariffs	H	H	H	H	L	L
	Export restrictions	L	L	L	L	M	M
	SPS	L	L	L	L	H	H
	TBT	L	L/M	L	L/M	H	H
	Services (GATS+)	M**	M	M**	M	L	M
	Investment (TRIMs+)	L	L/M	L	L/M	M	M
	AD-CVD	H	M	H	M	L/M	M
	TRIPs	L/M	L/M	L/M	L/M	M	M
	STE	L	L/M	L	L/M	L	M
	Government procurement	H	H	H	H	L	L
	Trade facilitation	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.
WTO beyond/extra (X)	Investment	M	M	M	M	M	M
	Competition policy	L	L	L	L	L	L
	IPRs	L/N***	L/N***	L	L	M	M
	Regulatory coherence	L	L	L	M****	M	H
	Labour	n. a.	n. a.	n. a.	n. a.	L	L
	Environment	M****	L/M	L	L/M	L	L
	E-commerce	H	L (?)	H	L (?)	H	H
	Labour mobility	H	H	H	H	L	L
Anticorruption/transparency	L	L/M	L	L/M	H	H	

\* Most industrial tariffs in participating countries are already low and covered in a wide range of RTAs/GSP schemes.

\*\* With negotiations covering market access in addition to regulatory measures, there is a potential for discriminatory measures.

\*\*\* An example is the possibility of introducing criminal penalties for “wilful” trademark counterfeiting and copyright piracy on a commercial scale.

\*\*\*\* Given the importance of both markets, the way in which such provisions in a number of issues are drafted might de facto discriminate against certain producers.

\*\*\*\*\* Prospects for reducing tariffs on environmental goods under the TPP and environmental standards might discriminate against outsiders even if, in practice, the tariffs are low.

° Given the importance of both markets, the potential for multilateralization is important, if not de jure, at least de facto.

Deeper-than-tariff provisions in deep RTAs like the TPP or TTIP need not create hard discrimination. Take the example of telecoms in the US-Peru FTA – an agreement that will be folded into the TPP. “Each Party shall ensure that enterprises of another Party have access to and use of any public telecommunications service, including leased circuits, offered in its territory or across its borders, on reasonable and non-discriminatory terms and conditions ...” This might seem like a hard preference, but it is not.

The point is, there is no effective way to exclude third-nation firms from this assurance. What is lacking is a good “discrimination technology”; it is just legally and administratively difficult to design rules of origins that identify the nationality of a modern firms. According to the FTA, an “enterprise of a Party” is any enterprise constituted or organized under the law of another Party as well as enterprises owned or controlled by a person of another Party. Toyota USA automatically qualifies for the “preference” in Peru since it is constituted in the US. Plainly, there is a preference, but very little discrimination; third-nation companies can – at a cost – benefit from the preference.

This example is not a quirk. Many of the provisions in mega-regionals will establish rules for treatment of firms, services,

intellectual property and capital. In most of these cases, effective discrimination technologies are not available. In today’s world, it is hard to determine the nationality of firms, services, capital and know-how. Or more precisely, it is relatively easy to work around such definitions. Thus, the advantages created by the mega-regionals on such topics will entail soft preferences rather than hard. The rules of origin for deep RTA provisions are easy to skirt and are thus “leaky”. Many of the commitments in the mega-regionals – indeed, all deep RTA provisions – resemble unilateral liberalizations that just happen to be bound by an RTA.

Other provisions in deep RTAs establish no preferences at all. The IPR chapter in the US-Australia FTA (which will be rolled into the TPP), for example, requires the parties to accede to various existing treaties.<sup>29</sup> These treaties are open, so the Australia-US FTA creates no preference. The FTA is merely a vehicle for locking in domestic reforms that are applied multilaterally.

While many mega-regional provisions can be thought of in terms of preferences, understanding the impact of regulatory convergence requires a very different mindset.

## Trade effects of regulatory convergence

Following in the footsteps of the original mega-regional – the EU’s Single Market programme – the harmonization of many diverse norms, standards and regulations is a key goal of both the TPP and the TTIP. Experience with the Single Market helps in considering the impact of regulatory convergence in mega-regionals.

Differing national standards create extra costs for exporting firms. Examples include the cost of bringing goods into compliance with the various national standards and obtaining certification. In WTO parlance, these are called technical barriers to trade, or TBTs. Harmonization reduces these costs, but not equally for everyone. If one standard is adopted, firms in the standard-setting nation get lower-cost access to the standard-adopting nations. Firms in other nations also see lower-cost access, but it may be costly for them to adapt to the new standard – costs not faced by firms in the standard-setting nation. In Figure 2, this is shown by the arrows indicating a reduction in regulatory-linked trade costs among members (taking the US and Japan as an illustration).

Importantly, this means that firms outside the mega-regional also benefit from accessing all member markets with one standard. This is shown in Figure 2 by the blue arrow from an outside nation (taking Indonesia as an example) to TPP nations. By analogy, it would be as if shallow-RTA members lowered tariffs between themselves and simultaneously lowered them against third nations. This is why regulatory convergence measures have nothing to do with the hard-preference thinking. They are more like a multilateral liberalization that benefits the member nations and third nation alike – even if the member nations gain more. Regulatory convergence tends to increase both trade among members and imports from the rest of the world.

The unusualness of regulatory convergence provisions goes one step further – such provisions can actually boost exports from RTA-based firms to nations that do not join the agreement (Francois et al. 2013). In Figure 2, this is shown by the red arrow from TPP nations to third nations like Indonesia. The usual example of this is the EU’s Global System for Mobile communications standard. When 300 million European consumers embraced this standard, many non-EU

nations embraced it as well. This helped Nokia and other EU firms compete in third nations. EU regulatory convergence helped EU firms win the global standards competition. More generally, regulatory convergence in areas the size of the TPP or TTIP tends to bring regulatory practices in line even in third nations. Switzerland and Norway, for example, are not members of the EU but adopt EU Single Market standards as they emerge.

Given the size of the EU market, firms must embrace EU standards. Firms do not want to have to adapt their products to national standards as well, so they push for unilateral harmonization with EU norms. Again, using the shallow-RTA analogy, it would be as if tariff cutting by shallow-RTA members induced non-members to lower their tariffs as well.

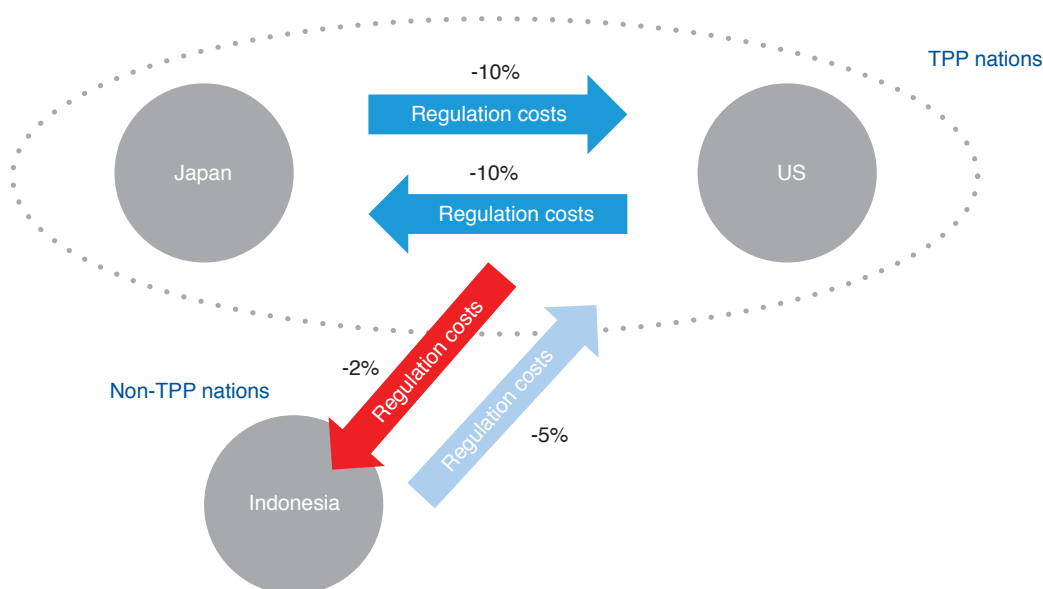
## Classifying mega-regional measures

Deep RTAs like the TPP and TTIP contain provisions that affect cross-border flows of goods, services, know-how, capital and people. There are also provisions that affect foreign-linked local production. Table 2 presents one possible classification. Roughly speaking, the hard preferences will mostly apply to provisions that address policies in box A or H – goods or people crossing borders. Provisions in boxes C, E and G tend to create soft preferences, or non-preferences due to the poor discrimination technology available for such flows. Provisions in box K also tend towards non-preferences, since policies that affect productive conditions tend to be blind to the nationality of the firms. When the nationality of the firms is identified, the malleability of corporate nationality weakens the preference.

## Evidence

A recent study by WTO researchers finds evidence that most RTAs seem to be creating soft versus hard preferences (Acharya et al., 2011). The evidence is that almost all RTAs have led to “reverse trade diversion” (Figure 3). That is, while the preferences increase trade among the partners, RTA imports from excluded nations also rise – just not as much. This is why they are called “soft” as opposed to “hard” preferences. The RTAs create trade for members and non-members alike, but the liberalization is slanted towards members.

Figure 2. Regulatory Convergence: Illustration of Trade Cost Effects

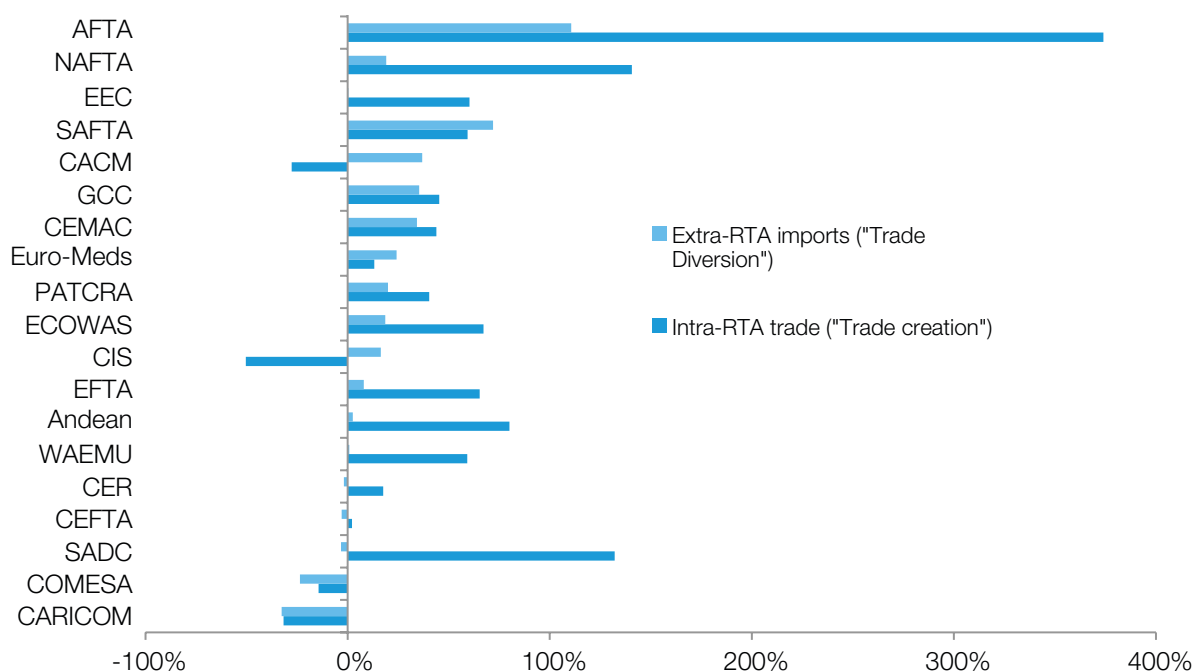




**Table 2.** An Economic Classification of Mega-regional Provisions

	At-the-Border Barriers (ABBs)	Behind-the-Border Barriers (BBBs)
Cross-border flows		
Goods	A Tariffs, quotas, frictional barriers	B Idiosyncratic regulations, etc.
Services	C Rare	D Idiosyncratic regulations; entry restrictions; state-sanctioned monopolies, etc.
Intellectual property	E Rare	F Weak protection laws, weak enforcement, pro-national enforcement
Capital (including FDI)	G Capital controls (inwards and outwards)	H Weak rights of establishment for foreigners, ownership restrictions, sectoral bans
People	H Visa	I Professional qualifications, residency permits, etc.
Foreign-linked local production		
GVC production	J Rare	K Weak property right assurances; enforcement or biased enforcement; poor business environment

**Figure 3.** Trade Creation and Diversion, Selected RTAs



Source: Acharya et al. (2011).

## 4.3. The Systemic Impact – Richard Baldwin

Mega-regionalism is good news and bad news for the world trade system. Trade liberalization has progressed with historically unprecedented speed in the 21st century. Trade volumes are booming; hundreds of millions have been lifted out of dire poverty. The policy reforms that underpinned this trade liberalization was implemented by a “spaghetti bowl” of deep RTAs, unilateral reforms and BITs. The good news is that mega-regionals will tidy up the spaghetti bowl – making the spaghetti into lasagne plates, so to speak.

The bad news is mega-regionals may undermine world trade governance – WTO centrality in particular. Trade liberalization in the past decades has had three parts: deep RTAs, BITs, and unilateralism. Unilateralism is not a systemic threat to the WTO and BITs have long co-existed with the WTO. But deep RTAs – and even more so mega-regionals – are very likely to erode the WTO’s central place in world trade governance. The threat is not on the tariff-cutting front; it is on the rules-writing front.

The danger is that mega-regionals may enfeeble the WTO as a forum for agreeing on new trade rules – specifically, the rules necessary to foster the trade-investment-services nexus that is the core of today’s international commerce. There are three main reasons to worry about the WTO being side-lined on the rule-writing front.

- First, the basic WTO trade norms are almost universally accepted and respected, but this universality stems in large part from the way they were promulgated – in multilateral negotiations where the GATT/WTO consensus principle held sway.

The new trade disciplines were promulgated in settings of massive power asymmetries – the deep RTAs signed by the US, EU and Japan with small to medium-sized developing nations. The mega-regionals are slightly less asymmetric since more than one giant is involved in each, but the small member and third nations still find themselves at a huge disadvantage. Lacking the legitimacy that comes from multilateralism and consensus, it is not at all clear that the new norms will be universally respected.

For example, some emerging markets – China, India and Brazil – are large enough to attract foreign investment and technology without signing deep RTAs, and they have so far shunned them.<sup>30</sup> China in particular might decide to reject the rules – creating something like a “Cold War of deeper trade disciplines”. This sort of distrust could spread beyond the new rules, especially if China, India and Brazil believe that the US is practicing what Fred Bergsten calls “competitive liberalization” (Bergsten, 1995) – that is, using RTAs to try to encircle them in a way that eventually confronts them with what might be seen as an ultimatum.

- Second, a world where the WTO is irrelevant to trade’s most dynamic developments (GVCs and supply-chain trade) is not a world that fosters multilateral cooperation on other issues.

Without a single forum for all trade and investment issues, it will be difficult to arrange the trade-offs necessary to make progress on trade-related policies that help with climate mitigation and adaptation, food shortages linked to drought or floods, etc. US, EU and Japanese interests may be served in the short term, and the interests of small to medium-sized emerging markets will likewise be served (if not evenly), but where do Brazil, India and China fit in?

These nations are not in a position to set up their own systems of deeper disciplines for the trade-investment-services nexus because they do not have advanced technology factories to offshore in exchange for host-nation reforms. By the time their multinationals are ready to make major outward pushes, the rules-of-the-road will have been written by the deep RTAs of the US, the EU and Japan.

If the mega-regionals conclude, they will have been firmly embedded in international commerce; the members of TPP and TTIP account for over half of world trade. More precisely, they will be embedded in the domestic laws and regulations of all the host-nations that the Chinese, Indian and Brazilian companies will be looking at. Like it or not, Chinese, Indian and Brazilian companies will have to play by the rules that are now being written by the mega-regionals.

If Brazil, India and China play their assigned roles in this storyline, it may all work out peacefully. But that is not the only outcome observed when such tactics were applied historically. This is a world that starts to resemble the 19th century Great Powers situation. That episode of globalization did not end well.

This is not the only scenario, of course – things could turn out well. A whole system of trade and investment disciplines has developed in the form of the BITs. Up to now, the BITs and their system of jurisprudence, negotiations and politics does not seem to have undermined the WTO’s authority on the issues covered in the 1995 Marrakesh Agreement. But as international commerce becomes ever more dominated by the trade-investment-services nexus, the WTO may be increasingly side-lined when it comes to trade governance.

- Third, the WTO’s adjudication function is still working well, but any dispute settlement system must “walk on two legs”.

The judges can connect the dots for particular cases, but the basic rules must be updated occasionally to match evolving realities. If the rules are being written in the mega-regionals, the only way to update the WTO rules is to multilateralize TPP and TTIP rules. That may be very difficult politically.

Mega-regionalism is not yet a disaster for the world trade system. The present trajectory, however, seems certain to undermine the WTO’s centrality – mega-regionals will take over as the main loci of global trade governance for beyond-WTO issues. Over the past 15 years, WTO members have “voted with their feet” for the RTA option. Without reform that brings existing RTA disciplines under the WTO’s aegis and makes it easier to develop new disciplines inside the WTO system, the trend will continue, further eroding WTO centrality and possibly taking it beyond the tipping point where nations ignore WTO rules since everyone else does.<sup>31</sup>

This scenario runs the risk that global trade governance drifts back towards a 19th century Great Powers world. In the best of cases, the WTO would continue to thrive as the institution that underpins 20th century trade flows. The Marrakesh Agreement would form a “first pillar” of a multi-pillar trade governance system. All the new issues would be addressed outside the WTO in a setting where power asymmetries are far less constrained. This is what has happened with the BITs – they established a parallel system of disciplines without substantially undermining the WTO’s authority on the Marrakesh disciplines. But this is not the only scenario. It is also possible that the WTO’s inability to update its rules gradually undermines the authority of the Dispute Settlement Mechanism.

If the RTAs and their power asymmetries take over, there is a risk that the GATT/WTO would go down in future history books as a 70-year experiment where world trade was rules-based instead of power-based. It would, at least for a few more years, be a world where the world’s rich nations write the new rules-of-the-road in settings marked by vast power asymmetries. This trend should worry all world leaders. In the first half of the 19th century, attempts by incumbent Great Powers to impose rules on emerging powers smoothed the path to humanity’s greatest follies – the two world wars.

The systemic impact of regulatory convergence deserves special mention due to its unusual effects (Figure 2).

### Regulatory convergence: A two-tier world?

Reducing the trade-inhibiting impact of TBTs requires that fewer norms are binding. Logically, there are only two ways of accomplishing this – the first approach is harmonization, and the second is mutual recognition:

- Harmonizing national norms so there is only one set of norms in the first place
- Recognizing multiple norms so that goods are only required to meet one set of norms to be sold in all markets

Negotiating harmonization is extremely difficult for political reasons. Even inside the EU, it proved unworkable (as evidenced by the failure of the EU’s so-called “Old Approach” from 1969 to 1984). All firms prefer just one set of norms, but they all want it to be theirs. Moreover, it is difficult (and time-consuming) to determine whether each proposed regulatory modification permits an equal level of regulatory protection in each nation. Additionally, it is difficult and time-consuming to determine their commercial impact. Since international negotiations must strive to balance commercial gains and each government must align a political consensus behind the final liberalization package, this second aspect of obscurity greatly complicates and delays TBT harmonization efforts.

Since negotiated harmonization is impractical, real-world regulatory convergence has taken the form of mutual recognition. But this mutual recognition is only extended to members of the agreement – the EU and the Australia-New Zealand Closer Economic Relations Trade Agreement being the two leading examples. Of course, much more harmonization has taken place, but it is of the “hegemonic harmonization” type. In Europe today, nations that are

dependent on the EU market (e.g. Switzerland and Norway) unilaterally adopt EU standards.

The key point is that mutual recognition is only possible among nations that trust each other’s governance systems – basically, rich nations. Consider the TTIP – an agreement among nations with a high level of regulatory standards, compliance and enforcement – and the TPP, which involves nations at very different levels of regulatory sophistication. The TTIP is more likely to make substantial progress on regulatory convergence. In any case, both mega-regionals are likely to lead to an outcome where poor nations are induced to adopt at least some rich-nation standards. In some cases, this might be good for them, but in others it might involve inappropriate restrictions.

# 5. Possible Responses to Mega-regionals

## 5.1. Potential Responses to Mega-regionals by Excluded Countries – Uri Dadush

The TPP and TTIP intend to reshape world trade rules for the 21st century. However, the negotiations exclude some 160 countries, which are home to over 80% of the world's population. These countries typically grow 3% a year or so faster than those included in mega-regional negotiations and, on current trends, may well account for over half of world trade in the not distant future. Thus, how the excluded countries respond to the rise of the mega-regionals is an important question not only for their citizens, but also for the United States, the European Union, Japan and the other 10 countries that are participants in the negotiations.

### Uncertainties and possible impact

Very large uncertainty is attached to the content and timing of the mega-regionals. Indeed, whether these enormously complex agreements will conclude at all, or whether they are reduced to a minimum common denominator outcome that does not commit the parties to much, is unknown. Even if the TPP, which is by far the most advanced, is agreed on in 2014, the confidence interval around the “bite” of its provisions is wide, ratification by the US Congress is uncertain and implementation of its more significant measures could take many years. Thus, even though their own policy response could require long lead times, many of the excluded countries may decide to adopt a wait-and-see posture. Furthermore, since any response requires commitment of negotiating resources and political capital, the excluded countries will be inclined to look for strategies that are robust to the many possible outcomes.

The starting point for formulating an appropriate response to the mega-regionals is how the agreements are likely to affect the excluded country's defensive and offensive trade interests. One can already predict that the vast majority of export sectors will be little affected by the TPP and TTIP since tariffs among the contracting parties are already low, and the reduction of many non-tariff barriers (such as custom delays and red tape) are likely to have MFN effects. However,

there will also be instances (garments, autos, sugar, cotton, etc.) where tariff peaks prevail and significant trade diversion could occur as a result of their reduction or elimination. And, while the adoption of common standards could open up new export opportunities, there will be instances, especially if the reforms take the form of mutual recognition, where the new standards provide a significant advantage to firms of the contracting parties. There will also be instances where import-competing firms in the excluded countries will be adversely affected, as firms of the contracting parties that compete with them will benefit from economies of scale, lower tariffs and improved cash flow. Many of the effects on both exports and imports will be indirect, as changes in the competitive position of one firm will resonate up and down the supply chain.

While much of the impact on excluded countries will occur in specific sectors and thus calls for careful monitoring of the provisions being negotiated at a micro level, one cannot lose sight of the systemic implications of the mega-regionals, especially as changing the global trade rules is set out as an explicit objective by US and European negotiators. If successful, the agreements could set up new benchmarks and approaches – for example in the life of patents or in policies governing exchange rates – which will either supersede WTO or eventually come to be integrated into WTO. Even if no attempt is made to broaden the reach of the new standards to other countries, their adoption by countries representing such a large share of global economic activity will be of great significance to exporters and import-competing firms around the world. In practice, this means that excluded countries will see their influence on the global trade architecture diminish. Moreover, even for the largest excluded countries, such as China, an individual response to the systemic effects of mega-regionals is unrealistic. It is instead likely to rest in coalition formation with like-minded countries who want to see different outcomes. A natural place to seek out such coalitions is in the WTO, but history shows that the pursuit of parallel or competing regional deals is the more likely path.

### Response

How should excluded countries respond? The tendency is to think of countries as led by an all-knowing and independent expert who will choose the public interest. In practice, the response to the mega-regionals will reflect the weight of domestic political interests and how they see themselves affected by the new trends. One implication is that countries

are unlikely to react until an important domestic constituency sees a clear threat or opportunity. Another implication is that the largest countries, especially those that see themselves as rising powers – such as China, India and Brazil – will probably react faster to the perceived systemic implications of the mega-regionals, including their geopolitical and security implications, than will many smaller countries who see themselves as little able to affect the system.

Following are the pure strategies that can be pursued, recognizing that they will sometimes be deployed in combination.

#### *1. Do nothing*

This is often a bad strategy but one to which many political systems naturally converge. In this case, the uncertainties are so big that it may make sense to wait and see, especially for small countries that cannot hope to affect the negotiations or to realistically craft a systemic response. Even then, countries will want to monitor developments closely and analyse the impact of alternative scenarios or outcomes on their most important trade interests. They may begin to devise strategies and send out feelers to trading partners.

#### *2. Reject, withdraw, obstruct*

This is the worst response. Countries are not likely to retreat into protectionism or obstruct WTO negotiations just because they do not like being excluded from mega-regionals. However, where influential domestic constituencies are hostile to trade anyway, the disappointments with multilateral approaches and exclusion from the most vital parts of world trade negotiations can play into the hands of anti-globalization lobbies and of those who argue that the dice are loaded. Although the modest progress made in Bali may have mitigated this risk, the shift of focus by the major trading powers onto mega-regionals will discourage countries that tend to be inward-looking, such as India, Brazil, Russia and South Africa, from adopting a more liberal stance.

#### *3. Enact autonomous reforms*

This is the best response to mega-regionals but also the least likely course politically. The mega-regionals do little to change the political economy of autonomous trade reforms in the excluded countries, and, if anything, strengthen the hand of protectionists. Still, if done at the right pace and with adequate companion measures, unilateral regulatory reform and trade liberalization can induce a supply response and reduce distortions, and are an effective way to prepare firms for the increased competition, tougher standards and bigger markets that successful mega-regionals would bring. Moreover, these reforms are robust – worth pursuing regardless of the shape that mega-regional may take.

#### *4. Join them*

One strategy, most likely to appeal to smaller countries eager to join the TPP, is to use the available “docking stations”. The downside of this approach for a small country is that it will mean being subjected to one of the most lopsided trade negotiations in history. Moreover, this path is very unlikely to be pursued by large countries, not only because the likes of China or Indonesia will not accept unconditional adoption of the TPP “acquis”, but also because the incumbents will be reluctant to open their doors so wide to a big, new source of competition without imposing additional conditions.

Given the complexities of joining a mega-regional after their conclusion has been reached, a more realistic approach is to enter into a bilateral negotiation with both the US, which is a way to get a large chunk of the market access under the TPP and TTIP, and the EU. Such an approach would provide a window to the regulatory reforms and tougher standards both trading powers are aiming for. Many smaller countries will be attracted by this option, even though the negotiations are likely to be lopsided. Larger countries, with greater bargaining power, may also pursue this route – as in the Brazil-EU and India-EU negotiations at present.

#### *5. Compete with them*

This strategy consists of joining competing regional arrangements or forming new ones. There is, however, nothing on offer that is likely to compare in terms of ambition or scope with the TPP and TTIP. The prospect of RCEP, which includes China, India and Japan – geopolitical rivals with very divergent trade agendas – resulting in a high ambition agreement is, to say the least, distant. Any number of other opportunities exist for countries to enter into far-reaching trade agreements with neighbours or with their most important trading partners in other regions, including those that are set to join the TPP (those joining TTIP are part of the EU Customs Union) and from whom one can “learn” the new standards. However, these agreements would be limited in their reach (proportion of trade covered). They would only be a very partial response to the mega-regionals and are best seen as a complement to autonomous trade reforms.

#### *6. Re-engage in the WTO*

This strategy could have been considered as pure wishful thinking before Bali. After the modest success in Bali, and given the growing realization that successfully negotiating the TPP and TTIP also presents great challenges, WTO re-engagement is perhaps a less far-fetched option for many countries, including those engaged in the mega-regionals.

Adopting a realistic post-Bali agenda in Geneva is not going to stop the TPP and TTIP train, but, if done right, could create a positive dynamic between the regional and multilateral negotiations. Indeed, the constructive role played in Bali by many, from the US to China, the LDCs and even India, may reflect concerns that the mega-regionals could render the WTO irrelevant and ultimately undermine its *acquis*. In some aspects of the mega-regional negotiations, for example on trade facilitation, the Bali agreement could represent the minimum denominator starting point, and advances in regional negotiations could eventually feed back into the multilateral sphere.

What appears unrealistic after Bali is the pursuit of far-reaching WTO agreements based mainly or exclusively on the single undertaking/consensus rule. To revitalize the multilateral system, countries involved in TPP and TTIP negotiations and those excluded will probably have to accept slicing up the Doha agenda (and the many issues which Doha did not address) into manageable pieces involving a critical-mass subset of countries willing to move faster and farther than the rest.

## Conclusion

For the countries excluded from mega-regionals and worried about the systemic implications for the global trade system, “plurilateral” or flexible geometry approaches within the WTO probably represent the only realistic response. Such approaches would form an important part of their overall national response to mega-regionals, which could also include autonomous trade reforms and the initiation of new bilateral or regional negotiations with the contracting parties to the TPP and TTIP, as well as with other important trading partners, enabling them to raise the competitiveness of their productive apparatus.

## 5.2. Regional and Country Perspectives

### 5.2.1 The Potential Impact of Mega-regionals on Sub-Saharan Africa and LDCs in the Region – Peter Draper and Salim Ismail

Sub-Saharan Africa does not have a seat at the mega-regional negotiating tables; yet, the region has a stake. Although the final substance and eventual ratification of TPP and TTIP negotiations remain uncertain, the ability of African nations to diversify market opportunities, integrate their economies in global value chains and attract sustainable investment could be affected. The long-term balance of benefits against risks will depend on the design of these agreements, supportive international policies and the strategic response of African policy-makers and firms. Four issues are relevant: new compliance measures; geopolitical dynamics; preference schemes; and international production networks. Transparency and monitoring will be an important basis on which sub-Saharan African nations can frame a proactive response.<sup>32</sup>

#### New compliance measures

The TTIP and TPP differ in their motivating factors and negotiating dynamics. However, beyond their geographical spread and respective weights in world economic output and trade, they hold in common the objective of reaching binding commitments on “21st century”, or “WTO-Plus”, trade-related issues.<sup>33</sup>

The TPP’s main focus is to reach agreement on disciplines configured to support the formation of transnational production networks, including intellectual property, investment, competition policy, services, customs procedures and investor-state dispute settlement. The TTIP builds on this with its core ambition of eroding non-tariff barriers to trade by agreeing to common standards and working towards regulatory convergence (through harmonization or mutual recognition). Both sets of negotiations further include chapters on labour and environmental norms, financial services, public procurement practices and market access.

Should new regulatory standards and disciplines emerge from the TPP and TTIP negotiations, they will, in all probability, apply to trade and investment relations with the rest of the world, including sub-Saharan Africa. The ability of African nations to attract investment and gain reliable access to mega-regional markets, most importantly the EU and the US, will progressively depend on compliance with non-tariff measures – both technical and non-technical – that go beyond the realm of traditional trade policies.

In the case of standards, meeting higher thresholds will entail regulatory changes without which African producers could be shut out of the markets concerned. This raises the problem of resource constraints and the ability to strengthen regulatory capacities. In regard to compliance with disciplines covering investment or intellectual property rules, domestic policy changes will be expected. This raises the issue of the appropriateness of adopting “gold standard” policies in weak institutional settings.

The depth of these behind-the-border requirements will not be without controversy. Yet, they could be exploited by African nations as an impetus for reform in areas of domestic priority. Depending on the nature of institutional and supply-side constraints, as well as the capacity to conform to new standards and disciplines, targeted assistance under the aegis of the Aid for Trade programme and broader capacity building efforts will be required.

#### Geopolitical dynamics

The geopolitical foundations and possible implications of the mega-regionals on the international trading system should not be lost in the discussion on their potential impact on sub-Saharan Africa.

As other sections of this report explore, there is disagreement among analysts whether the mega-regionals represent “building blocks” towards multilateral convergence or “stumbling blocks” towards fragmentation. Systemic scenarios will hinge, to a great extent, on how China responds and whether one of the unstated objectives of the US-led mega-regional drive, that of not necessarily excluding China but rather compelling the world’s second largest economic power towards accepting new norms and rules on pre-established terms, leads to gradual consent or contest – particularly in the context of a powerful Asia-Pacific coalition like the TPP where China is by design an outsider to negotiations.<sup>34</sup>

This geopolitical dimension is of relevance to sub-Saharan Africa at a time when the continent’s trade and investment patterns are undergoing a profound and seemingly secular shift from traditional economic partners to intensified relations with fast-developing centres of world commerce.

The EU as a bloc remains sub-Saharan Africa’s largest trading partner, yet its share of total trade halved between 1989 and 2011 from 50% to 25%. In 2011, the US accounted for 12% while China had become sub-Saharan Africa’s biggest bilateral trading partner with 15% of the region’s total trade. The speed and scale of China’s engagement with the continent has been a game-changer.<sup>35</sup>

The backdrop to the mega-regional effort is one in which sub-Saharan African nations are concurrently engaged in discussions with major partners over institutional arrangements of long-term developmental and strategic importance. The African Growth and Opportunities Act (AGOA) – the centrepiece of US economic relations with the region since 2000 – is up for renewal in 2015 with a fair degree of uncertainty regarding the terms of any new agreement. AGOA has been characterized by its unilateral and non-reciprocal nature, features that are up for discussion, specifically with regards to sub-Saharan Africa's biggest economies and most dynamic markets. An important factor behind this reasoning is that the EU is hoping to finalize arduous negotiations on regional Economic Partnership Agreements – the foundation since 2008 of Europe's economic integration with sub-Saharan Africa, which (with the exception of least developed countries) is built on reciprocity, hence preferential access to African markets for European firms.

Since 2000, the Forum on China-Africa Cooperation has served as the main stage for Sino-African bilateral relations. Recently, there have been moves to formalize trade and investment arrangements with African regional groupings through initial Framework Agreements with the East African Community (EAC) and the Economic Community of West African States (ECOWAS). China, too, may start to demand reciprocity with certain partners.

A question that arises is how sub-Saharan African nations and regions will react should mega-regional agreements fail to reach coherence and lead to fragmented governance structures within the international trading system. The immediate tendency may be to gravitate towards European and US partners – especially if existing preference schemes are strengthened and the EU makes African economic development a strategic priority. However, the emerging centres of growth, trade and investment are largely to the east. While the future velocity of this shift in world economic gravity can be debated, the expectation is that Asia will continue to experience significant economic convergence and that South-South trade and investment dynamics with Africa will amplify. A discussion on the region's double-edged economic relationship with China, including the possibility of future regulatory demands, would seem to be a priority.

### Box 3 – South Africa and the Mega-regionals

South Africa is tangential to the new great global mega-regionals game. The country accounts for a small share of global trade and output, although it looms large in the African context. Nonetheless, with the most diversified economy in Africa and trading interests that span the US, the EU and East Asia, it undoubtedly has a substantial stake if these agreements do come to fruition. But the nature of the stake depends on which region is in the frame.

South Africa exports a substantial quantum of relatively advanced manufactures to both the US and the EU, in addition to its typical resource profile. Furthermore, the great majority of inward FDI into South Africa is sourced from the EU, and to a lesser extent the US and Japan. On balance, therefore, the TTIP is of most direct significance. Furthermore, both the TTIP and the TPP may result in a degree of trade and FDI diversion, of manufactures in particular, to signatory countries. That could have implications for certain South African industrial and agricultural exports to the EU market in particular.

In the Asian case, resources dominate the export footprint. To the extent that the TPP and the TTIP promote economic growth in both regions, that would provide important stimulus to South Africa's resource exports. They have been constrained in recent years, mostly owing to domestic policy constraints, which may intensify since the South African government lays great stress on adding value to resource exports. Consequently, export taxes, FDI conditionalities and domestic ownership requirements are gathering pace in the domestic policy debate. Hopefully, this will not result in substantial new hurdles to resource exports, favouring competitors such as Australia over South Africa.

Furthermore, in the wake of TPP and TTIP conclusion, other competitor countries may secure deals with the EU and US that will offset the erosion of their preferences into those markets. South Africa has a trade agreement with the EU, although this covers goods only. It currently enjoys almost duty free access to the US, but periodic threats to graduate the country may at some point materialize, particularly in the case of AGOA. The country does not have any preferential deals with Asian countries – a major gap in its PTA architecture.

Overall, South Africa's domestic policy trajectory points increasingly inward, towards import substitution and reindustrialization. Chronically high unemployment rates and persistent inequality have entrenched defensive approaches to trade. The leadership of the trade ministry refers to the narrative on global value chains as the "new Washington consensus". Hence, liberalization and upgrading trade-related rules are not on the agenda. Indeed, the reverse is true: bilateral investment treaties are being cancelled and replaced with an investment promotion law which in its current incarnation could result in intrusive conditions being imposed on foreign investors. Consequently, South Africa will continue to see its preferences erode in key external markets, while foreign firms increasingly re-evaluate their approaches to FDI in South Africa in favour of other African "gateway" countries.

This inward-looking approach is being transposed into the region. From the South African government's standpoint, the African growth story is the next big thing, and South Africa is the gateway – at least to Southern Africa. Consequently, if the regional market can be secured for South African companies, it could work in the country's favour. However, this logic is likely to encounter swelling regional resistance, challenging South African leadership. This will undermine South Africa's role as the regional economic gateway: since gateways are conduits, they must necessarily be open to trade and investment. Furthermore, regional markets are no substitute for South African companies' broader interests in Europe, the US, and East Asia.

South Africa could continue to gradually seal off the domestic market and hope that the world will engage it on its own terms. But that course will undermine the country's international competitiveness, and a post Mandela world is likely to look elsewhere. Instead, South Africa should be thinking seriously about how to position the country for the future global trading system.

### Preference schemes

The TTIP could provide an opportunity for the EU and the US to jointly revisit trade preference schemes to support the development objectives of sub-Saharan African low-income countries. The Trans-Atlantic partners apply distinct non-reciprocal arrangements that offer special access to African nations and least developed countries – the most comprehensive of which are AGOA and Everything but Arms (EBA).<sup>36</sup>

In 2013, sub-Saharan Africa accounted for 2% of world trade and less than 3% of global FDI flows, with extractive industries drawing the lion's share. Liberal access to developed markets, as envisioned by the policy thinking behind AGOA and EBA, could help stimulate investment and job creation in agricultural, manufacturing and service export sectors. However, despite their successes, both schemes suffer from limitations that curtail their utilization and effectiveness.

To cite some of the most commonly echoed weaknesses: AGOA excludes and applies tariff quotas to key products the region can produce competitively, not least agricultural products;<sup>37</sup> EBA provides full duty-free, quota-free coverage but only to countries classified as LDCs, thereby driving an arbitrary wedge within the region; the administrative costs of compliance to complex local content requirements can be prohibitive to firms operating in LDCs; the rules of origin required for product eligibility are seen as ill-adapted to the development of value chains; and AGOA's annual review mechanism added to the uncertainty of the scheme's renewal post-2015 reduces security of access.

There is as yet no evidence that the harmonization of preference schemes is on the agenda of the TTIP.<sup>38</sup> However, short of integrating their preferential arrangements, the EU and the US could send a strong message to their African partners that the agreement is about coherence and inclusion by mutually recognizing requirements covering rules of origin. This not only would reduce information costs and ease compliance procedures for African exporting firms, it also, in principle, would allow imported products from African countries covered by preferences to be granted reciprocal access to EU and US markets.

### AGOA (Enacted by the US in 2000)

**Applies** equally to sub-Saharan African LDCs and non-LDCs, although it offers added benefits to LDCs by providing duty free treatment to products covered by the generalized system of preferences as well as flexible rules of origin on apparel (Third-Country Fabric provision).

**Eligibility** is reviewed annually and determined by political conditionality (rule of law, foreign policy objectives, barriers to trade and investment, etc.). Added LDC benefits are defined by economic criteria (per capita ceiling with exceptions).

**Beneficiaries** in 2013 included 40 of the 48 countries in sub-Saharan Africa, with 24 covered by LDC provisions.

### EBA (Enacted by the EU in 2001)

**Applies** uniformly to all LDCs worldwide including African LDCs by providing full duty free, quota free access under specific conditions of origin. Trade relations with sub-Saharan African non-LDCs fall under the reciprocal Economic Partnership Agreements.

**Eligibility** is determined by generalized system of preferences requirements that include economic criteria (LDC status defined under a UN ranking based on per capita income, human assets and economic vulnerability) and basic political criteria (human rights).

**Beneficiaries** in 2013 included 27 of the region's 34 LDCs, while excluding low-income countries not classified as LDCs.



## International production networks

The fight for relevance in 21st century trade is increasingly being conducted via GVCs. Despite the developmental potential that disaggregated production networks hold for low-income economies in Africa by allowing for the formation of capabilities and clusters in a narrow set of specialized tasks, the region has essentially been bypassed.<sup>39</sup>

Most models predict that the mega-regionals will not lead to significant trade diversion and that any loss could be compensated by the efficiency gains to the global economy.<sup>40</sup> This prognosis will depend on how the agreements are designed (e.g. an approach based on open regionalism with accession clauses or “docking stations”) and the manner in which the EU and the US decide to integrate the many trade agreements they hold with third countries and regions (e.g. mechanisms covering the cumulation of rules of origin).<sup>41</sup>

The TTIP, TPP and RCEP incorporate all three GVC hubs: Europe, North America and East Asia. There is a risk that these agreements could have negative spillovers on the incentive to invest and stimulate actual and potential production in sub-Saharan Africa.<sup>42</sup>

As discussed, generous preference schemes in developed markets with rules adapted to the realities of modern trade could spur African export diversification. The operationalization of the LDC Services Waiver and the implementation of the Trade Facilitation Agreement, as agreed at the WTO Ministerial in Bali, may also form part of a supportive international policy environment, which will need to be complemented by national and regional policies.

Although many economies in sub-Saharan Africa have consistently grown faster than other regions of the world in recent years, primary commodities have driven a large share of this growth. Most African nations need to implement reforms that improve their business environment and attractiveness as investment destinations so they can develop their potential in manufacturing activity and agricultural productivity. Modernized infrastructure and backbone services (logistics, telecommunications and transportation) are further preconditions to competitiveness and the ability to tap into sophisticated production networks.

Securing greater depth and coherence to existing regional integration efforts will also be an important strand in sub-Saharan Africa’s effort at creating an environment conducive to the expansion of value chains. Official intra-regional trade between African nations stands at around 10% (compared to 30% for ASEAN nations). This weak integration is partly driven by the lack of complementarities between the region’s economies, but also by the prevalence of high barriers to trade: the cost and complexity of conducting business across borders severely restricts the ability to form regional value chains. Given the low level of intra-African trade, Africa will remain dependent on external forces for a long time, and these forces will require the greatest adjustments in the near term. However, initiatives at the regional level could be used as laboratories for reform and for building regional value chains with an eye on graduation into global production networks.

A recent initiative of note that underscores the awareness of the need to better integrate and harmonize regional economic communities is the SADC-EAC-COMESA Tripartite.<sup>43</sup> The agreement is to be based on three pillars (market integration, infrastructure and industrial development) with an agenda in two phases that includes trade in goods (tariffs, non-tariff measures), rules of origin, customs cooperation, dispute resolution) followed by services, intellectual property, competition policy and investment – all of which were until recently rarely considered in African regional trade agreements and could better prepare Africa for the post mega-regional environment.

## Conclusion

One of the consequences of mega-regional activity is that the influence of sub-Saharan Africa on the global trade and investment agenda will diminish – the region relies on the World Trade Organization to be heard and has very little bargaining power to push its interests forward outside of the organization. Nevertheless, sub-Saharan African policy-makers can devise strategies aimed at building on the opportunities and curtailing the risks occasioned by the mega-regional agreements. This entails closely monitoring the negotiating chapters, working with partners to ensure that the potential for discrimination is minimized and creating a domestic and regional economic environment that invites confidence.

## 5.2.2 The Potential Impact of Mega-regionals on the Asia-Pacific Region and China

### 5.2.2.A – Impact of Mega-regionals on the Asia-Pacific Region – Sherry Stephenson

The Asia-Pacific region is at the centre of three of the largest mega-regional negotiating efforts, namely the Trans-Pacific Partnership, the Regional Comprehensive Economic Partnership and the tripartite China-Japan-South Korea free trade agreement negotiations. From the start, the Asia-Pacific has been one of the main drivers of the mega-regional phenomenon and is at the centre of the ongoing transformation of the world trading system. The TPP effort involves 12 countries representing 60% of world GDP, 40% of the world’s population and 33% of world trade, while the 16 RCEP participants represent 33% of world GDP, 45% of the world’s population and almost 30% of world exports. The TPP originated from an Asia-Pacific agreement of four core countries, while the RCEP is being led by the 10 ASEAN members. Although only involving three countries, the CJK FTA talks might also be considered a minor mega-regional effort, given the size of the three participants that represent 20% of world GDP and nearly 20% of world exports.

As regards the progress of these negotiating processes in the Asia-Pacific, the RCEP negotiations are only now getting underway, while the CJK FTA negotiations are moving at a slow pace due to political tensions that creep into the process from time to time. The TPP negotiations are the closest to being concluded, but there are strong elements of uncertainty that still need to be resolved, including ongoing market access differences between the US and Japan, differences

over the strength of IPR protections to be included in the agreement and the question of Trade Promotion Authority in the United States where US Trade Representative efforts have not yet led to a foregone conclusion in the Congress.

Several informal deadlines have already come and gone. But if and when successful, the TPP will put a new face on trade rules and trade relations, and will have a significant impact at the multilateral level on the direction of future trade rules, either in other regional agreements or eventually in the WTO itself, as it may well evolve through plurilateral agreements on specific issues in the future. These issues are likely to be ones that have already been addressed in the TPP and where a normative framework will have been developed. Thus, the TPP may prove key to driving future trade relations among major trading partners; only time will tell. It is well acknowledged already that South Korea is preparing itself to request adherence to a future TPP.

For its part, China is watching the TPP closely, while working diligently to participate in as many key FTAs as possible so that it will be ready to adhere to the agreement at some point in the future should it choose to do so.<sup>45</sup> China has requested a pilot study on the feasibility of an FTA with the United States that should be considered by its economic leaders in mid-2014. The US and China restarted negotiations on a Bilateral Investment Treaty, and these should be nearing completion as of mid-2014.<sup>46</sup> An investment treaty is generally viewed as a necessary step towards a possible free trade agreement.

The first visit of a Chinese President to the European Union took place on 1 April 2014 when President Xi Jinping was received in Brussels to discuss deepening the economic relationship between China and the EU. The two trading powers are already well into negotiations of an EU-China Investment Agreement covering investment protection and market access. The Joint Statement issued at the time of the meeting importantly mentioned the future negotiation of a “deep and comprehensive FTA”, when the conditions are right.<sup>47</sup> China has also requested its participation in the Trade in Services Agreement (TiSA) negotiations, ongoing in Geneva, breaking the solidarity of the BRICS in this regard and clearly putting its own trade and development priorities above those of political concerns.

Many Asian countries are involved in more than one of these three ongoing major and minor mega-regional initiatives, which raise questions about the depth of the different agreements, their relationship to each other in terms of disciplines and extent of liberalization, and the motivations of the participants in each case. Several analysts have written about the TPP and RCEP as two alternative paths towards an envisaged Free Trade Area of the Asia-Pacific, which is the stated goal of APEC.<sup>48</sup> More recently, analysts have begun to posit a future possible “fusion” of the TPP and RCEP in order to read the FTAAP, as it is doubtful that some of the ASEAN members at lower levels of economic development would be able to accept the higher TPP norms and standards for many years. This possibility of a fusion would lie far down a future path, and the position of the US in such a situation would be unclear.

The TPP, if and when finalized, will have a major impact on the conclusion of other mega-regionals, as well as on the Asia-Pacific region itself. It should provide a stimulus for the RCEP and the CJK FTA talks to move forward with more vigour and to incite these other two efforts to aim for a deeper level of disciplines and commitments. A finalized TPP should also be a strong catalyst to push China to reflect on its ultimate goals in the Asia-Pacific region. As a regional leader, China should logically wish to be a member of both, but currently only Japan is in this position. China may or may not choose to be one of the driving forces in trying to consolidate the TPP with the RCEP provisions to move towards an FTAAP.

It is worth noting that the RCEP is the only mega-regional in which China and India are participating, two of the key members of the BRICS. As such, it is an important initiative that merits close monitoring. In this context, it is particularly interesting to highlight the recent change in India's attitude towards participation in free trade agreements. Commerce Secretary Rajeev Khler has recently pronounced himself publicly in favour of the RCEP, claiming that it is an important pact for the country and that the industry should be prepared to avail itself of the opportunities derived from it.<sup>49</sup> He emphasized the key role of exports as a necessary ingredient of economic policy and indicated that India's export strategy would be mainstreamed into government structures and objectives. Khler also said “RCEP is an extremely important agreement for India and it can be a game-changer. RCEP is a big challenge to industry because we need to equip ourselves to deal with the possibilities of opportunities that are coming out of RCEP”.<sup>50</sup>

The mega-regionals that are currently under negotiation in the Asia-Pacific region, given the importance of the economies involved in these integration processes, should serve to change the panorama of the world trading system over the next decade, with important implications as well as for countries outside and inside the region.

First, the new Asia-Pacific mega-regionals will draw more economic activity into the region, through further enhancing its dynamism and attractiveness for foreign investors and traders. The greater integration of Asia-Pacific markets will serve to expand the scale of productive operations and break down remaining barriers to trade even further, especially in the services area. Improvements in the running of certain service sectors such as transportation, telecommunications, ICT, logistics and financial services will result in a huge contribution for the formation of international production and distribution networks.

Second, these large agreements will have relatively less discriminatory effects on the rest of the world than smaller agreements would have, meaning that trade diversion should not be a major worrying factor for countries outside the region. In fact, the economic stimulus to be provided by the TPP and/or RCEP could be considerable, both for economic growth and for trade growth.<sup>51</sup> The larger the mega-regional, the larger the beneficial impact will be on both members and global GDP and trade. According to a study by Petri, Plummer and Zhai (2011), the effect on the world economy would be small initially, but by 2025 the annual welfare gains would rise to \$104 billion on the TPP track, \$215 billion on

the RCEP track and \$303 billion on both tracks. An eventual region-wide agreement (FTAAP) would generate even larger benefits – \$862 billion – by 2025. Logically, smaller countries would benefit immediately and more significantly than larger countries.<sup>52</sup>

Third, the new mega-regionals in the Asia-Pacific will impact patterns of trade and FDI through reinforcing and expanding existing supply chain operations. The members of the potential future Asia-Pacific major and minor mega-regionals (TPP, RCEP and the CJK FTA) are already at the centre of current supply chain structures as sources of demand – Japan, Australia and North America (the US, Canada and Mexico in the TPP) – and centres of supply – China, Japan and South Korea in the RCEP and the CJK FTA. A successfully completed RCEP with significant market-opening disciplines, especially in the services area, should help to expand the operation of current value chains further into South-East Asia through greater involvement of the ASEAN members, potentially including part of the Indian economy as well.

These potential future implications of the mega-regionals should be a major source of worry for countries outside the Asia-Pacific region, as it will likely make it more difficult for them to break into and participate in these supply chains. For outside countries, it will be important to find ways to link their trade and investment patterns with the Asia-Pacific region, such as the five members of the Pacific Alliance in Latin America (Chile, Colombia, Costa Rica, Mexico and Peru) are trying to do in their new trade agreement through expanding the attractiveness and scale of their economies to Asian investors. It may encourage countries outside of the Asian mega-regionals to think of trying to “dock” a future FTA with one of the major agreements.

From an institutional perspective, a potential future TPP and RCEP, and possibly a CJK FTA, or in a more distant future, an FTAAP, could serve as models the WTO might draw upon to reflect on future reform, especially as it approaches its 20th year mark in 2015. With so many of its main traders already experimenting with new rules and models for trade agreements, WTO members might find it easier to consider some of these new frameworks as an inspiration for a possible overhaul of current rules, breaking down the silos between trade disciplines and incorporating investment within the multilateral trading system rules to better reflect the integrated 21st century trading economy. The only thing that seems quite clear in this moving picture is that the Asia-Pacific region and its economies will be at the heart of the action in this transformation.

### 5.2.2.B A Geopolitical Perspective – Jean-Pierre Lehmann

The philosophy of the post-World War II rules-based multilateral trade regime was that it should be divorced from geopolitical considerations and that trade should no longer, as it had in the pre-war decades, serve as a weapon in the armoury of offensive foreign policy. It was further assumed that an open rules-based trade system would contribute to peace and prosperity. When contrasting the first and second halves of the 20th century, there can be no doubt that the system was outstandingly successful, not only for the established trading powers, but also for aspiring ones,

notably the “four dragons” in Asia-Pacific, later China after its reforms, as well as the ASEAN countries. Japan, China, Hong Kong, Singapore, Taiwan, China and South Korea owe much of their growth and prosperity in recent decades to the international trade system.

While the Asia-Pacific economies are highly and tightly integrated in the contemporary international economic system and indeed major actors through global value chains, the politics and geopolitics of the Asia-Pacific are in respects reminiscent of those in Europe of the late 19th and early 20th centuries.

There was Great Power rivalry. It is, after all, just over a hundred years ago that Britain invaded Tibet (1903-1904) to thwart perceived Russian ambitions in the Far East. While there were numerous rivalries between the Great Powers, the biggest rivalry of all was between Germany and Britain. The fact that they were each other’s biggest trading powers did not prevent war.

Indeed, trade and investment had been booming in Europe (as in Asia-Pacific today), convincing many, in the famous words of Norman Angell, that “international finance is now so interdependent and tied to trade and industry, that political and military power can in reality do nothing”. The fact today that Japan, China and South Korea should be each other’s main trading partners and that they are highly interdependent economically cannot by itself guarantee the absence of conflict. Furthermore, the parallels between Germany and Britain in the early 20th century and China and the US in the early 21st deserve attention; attention, not obsession. As Mark Twain mused: “History does not repeat itself, but it does rhyme.”

In early 20th century Europe, booming trade and investment were in part driven by an intense arms race. We see this in Asia now, not only in China, but also in India, Vietnam, Singapore and the Philippines, and, if Prime Minister Abe has his way, there will be increased military expenditure by Japan.

As was the case in Europe a century ago, there are strong currents of nationalism in Asia. This is especially true in China, not entirely surprising in view of how much it suffered from the Western powers and Japan in previous centuries. A resurgence of nationalism also exists in Japan, symbolized by the recent visit of Prime Minister Abe to the Yasukuni Shrine.

This nationalism, often ultra-nationalism, was fuelled by and further exacerbated the fundamental mistrust that prevailed. In *The War that Ended Peace*, Margaret MacMillan writes about the European powers in the early 20th century that “highlights the irrational and uncontrollable hatreds between people who had so much in common”. In East Asia, this phenomenon is especially glaring in respect to relations between Japan and South Korea: both democracies, both major economic powers, both dependent on a benign and dynamic global trade system, yet both are at daggers-drawn because of profoundly wounding historical legacies arising from Japan’s colonization of Korea (1910-1945) and especially during World War II, and by an ongoing territorial dispute over the Dokdo/Takeshima Islands.

In saying that Asia-Pacific is a geopolitical cauldron is by no means to imply that war is inevitable. Trends can be reversed. But one of the ways of seeing a nightmare scenario materialize is to ignore the dangers. To say that war is inevitable is the height of irresponsibility and inhumanity. To say that war is impossible comes a notch just below. As *The Economist* noted: “The most troubling similarity between 1914 and now is complacency.”

Asia-Pacific lacks trust, confidence-building measures and solid institutions. Given this context, what can be the role of the trade regime? For Asia-Pacific (as for the rest of the world), there can be absolutely no doubt that priority must be given to the rules-based multilateral trade system. The recent “victory” of the WTO Bali ministerial meeting provides a much needed gust of encouraging air. But, again, complacency would be very dangerous.

The CJK FTA initiative is to be encouraged, not because of expectations that concrete results are down the road, but because at least it creates a rare forum for the three to talk.

As ASEAN is one of the very few cross-border institutions in Asia-Pacific and as it has been quite successful since its establishment in 1967 – over the decades having seen South-East Asia transformed from a battleground to a marketplace – its potential positive leadership deserves recognition and support. RCEP, therefore, seems worth betting on.

TPP, on the other hand, is much more contentious. Even though the intention may not be geopolitical, it is impossible, given the realities in Asia-Pacific, to ignore geopolitical considerations and possible ramifications. It is perceived as the economic arm of the US’s strategic “pivot to Asia”. The facts that it is driven by the US and that it excludes China by nature make it divisive, exactly at a time when every effort should be focused on making Asia-Pacific more cohesive and united.

Creating a dynamic, open, inclusive and solid trade regime in Asia-Pacific should best be left to Asian initiatives and leadership, with international support. The Asia-Pacific region is geopolitically fragile. Upsetting it in any way by mega-regional trade initiatives that insufficiently take into account these realities could have catastrophic consequences. As Winston Churchill said: “The farther back you can look, the farther forward you are likely to see.” In looking back at 1914, there are lessons for 2014 and beyond.

In this context, there is one vital lesson that refers to the role of business. As *The Economist* notes, “Businesspeople today are like businesspeople then: too busy making money to notice the serpents flickering at the bottom of their trading screens.” Business needs to take the geopolitical realities of Asia-Pacific seriously, be less myopic, be less inclined to take wishful thinking for analysis, and think longer term.

### 5.2.2.C – TPP and China’s Response – Wan Meng

Economic integration in Asia is largely market-driven and the expansion of trade in parts and components is achieved through the development of regional production networks or fragmentation. China, a large final assembler positioned at the hub of the production networks in Asia, is a catalyst

in this development. The priority in Asia now is to deepen integration and increase the density of networks to close the development gaps between nations. The Asian integration style, “soft regionalism”, is somewhat flexible and follows an incremental path.

The TPP agenda, which mainly includes Asian participants, ironically appears to disconnect with the regional initiatives for the following reasons. First, the TPP is not in the Asian integration style and therefore could jeopardize the achievement and the long-term goal of an FTAAP. Second, China, the trading powerhouse of Asia, is excluded from the TPP.

#### China’s exclusion from TPP is unlikely to undermine China’s dominant role in Asia’s economy

The regional integration (in a wider context based on a TPP) may meet difficulties without China’s involvement. Consider Japan, for example. As China has emerged as Japan’s top trading partner, Japan tries hard to bring China in with a bilateral FTA. This assertion made by Japan is a clear illustration of the strategic importance of China.

A TPP alone cannot change the existing structure of economic integration in East Asia. China has concluded agreements with ASEAN10, Singapore, New Zealand, Chile and Peru, and is engaged in negotiations with Australia. Such pre-existing links suggest there will be moderate economic benefits for China in joining the deal. Therefore, the American engagement in Asia through the TPP is not likely to isolate or pose a threat and undermine China’s regional identity. Though the TPP may deconstruct East Asian cooperation and reconstruct trans-Pacific cooperation, the growing China-Japan interactions suggest the potentials for creating a powerful Asian trading bloc.

Further, South Korea’s recent interest in integration with the East Asian region calls for the realization of pushing for broader regionalism. The trilateral partnership between China, Japan and South Korea is important as these three economies account for 90% of East Asian GDP.

#### China’s strategic response to a US-led TPP

A cornerstone of Obama administration policy is to use agreements like the TPP as a component of an integrated approach to development policy. The TPP is therefore used as a socio-political tool to institutionalize a “super-sized” next generation trade deal that includes the free movement of goods, services and capital, and even labour. A TPP means to set the social, political and economic tone of the conversation about the methods and values of transnational economic activity in strict accordance with US standards. Therefore, for the US, the TPP represents a means of leveraging power and participating in emerging global conversations about the structures of acceptable behaviour.

The US is also using the TPP as a vehicle for undermining efforts to revive and promote the WTO agenda. The US believes that WTO multilateralism should include more regionally specific agreements. The TPP and the related Trans-Atlantic Trade and Investment Partnership for Europe represent an alternative for developing the governance

framework for international trade, one in which smaller groups of individual states reflect the priorities of the member states. These reveal the WTO's continuing work among powerful like-minded states.

### The "China containment" argument

The notion of "China containment" means that the TPP is nothing but a vehicle through which the US strategically confines China's influence within the Asian-Pacific region, to restructure the economies therein to the benefit of the US. Most observers believe that China's exclusion from the TPP will lead to substantial economic loss and gradual deprivation of its existing norm-setting power within the region. They argue that because the TPP would shift production and services from China, reduced exports would compel China to resort to domestic consumption, a growth factor yet having to reach its full potential. The US then gains from the conclusion and implementation of the TPP, being again the pivot of the Asia-Pacific economy. Therefore, China has to join the TPP negotiation as early as possible, to avoid the aforementioned adverse effect should China be excluded.

The China containment argument offers insights into the relationship between the US and China, and the function of the TPP in balancing such a relationship. Nonetheless, China's approach to the current US-led TPP negotiation has to be more strategic, responsive to reliable facts and expectations in international trade.

### Problems with current US-led TPP

*The ratification of the TPP would be more difficult than expected*

A TPP-type FTA is unpopular among many developed countries and the lagging ratification process has led to continued domestic critique of the US participation in the TPP negotiation, concerning whether the US would gain from it. For example, for import-sensitive US sectors, Japan's participation in the TPP could mean increased competition from Japanese products, including in certain agricultural sectors and in the US auto and auto parts sector. Some civil society organizations suggest that since the TPP's power shift will further undermine democratic values and national supremacy, the TPP is more than a negative economic harmonization agreement. It is foreseeable that the ratification and implementation of the TPP agreement in the US Congress would be complicated and its final acceptance among participants remains an open question.

*The TPP's less transparent process would undermine its accountability*

The TPP process has been criticized for the deviation from the usual pattern of permitting a lively engagement by civil society. The 16th round, for instance, excluded many countries from the TPP negotiations, including China. A group of international law professors and US Senator Daniel Patrick Moynihan criticized that the TPP's deviation from the international standard of transparency creates a basis in the international community to challenge its institutional legitimacy. Such a risk would harm any existing participant's confidence in the viability of this international organization, creating more political puzzles.

The above observations serve as a reason why China should leave alone its successful implementation and enforcement domestically and internationally. China may choose to be more patient, in a reasonable expectation that the TPP would mature into a less comprehensive, less coercive and more lenient FTA. Otherwise, history would tell that an international economic integration agreement of such a nature would face its demise well before its ratification.

### Adverse effects of China's exclusion from the US-led TPP

China should be concerned that its exclusion from the US-led TPP has potential risks for China's economy and status within the Asian-Pacific region.

*Foreclosure of market access and the resulting trade diversion from China*

The pressing concern for China is the resulting exclusion from the preferential market access accorded to TPP members and the US. For example, the US would stand to lose \$25 billion in exports and \$5 billion in the form of welfare following the East Asia Free Trade Area's (EAFTA) negative trade-diversion effects to non-members. If the TPP would be ratified with China being excluded, China would stand to lose substantially in its exports and in social welfare in general.

*The TPP's comprehensive norm-setting scheme may undermine China's leading role in Asian FTAs*

Apart from market access, China's existing FTAs within the Asian-Pacific region are narrower in the coverage of trade in goods and services and having no WTO-plus provisions.

The TPP is supposed to deal with 21st century issues that other existing FTAs do not cover. The main problem lies in the so-called "platinum" norm-setting standards the US is pushing for in the TPP negotiations. These include stronger IPRs, tighter labour and environmental standards, and regulatory discipline of state-owned enterprises. These standards are less consistent with China's traditional principles of international relations. If China were excluded from the negotiation stage of a TPP, China would be compelled to make concessions.

Problems related to accession to the TPP mean that accession of future members have to be negotiated separately, undeniably leaving the veto power with the original signatories. In this respect, instead of the TPP being inclusive in terms of its membership, it may in fact be the reverse.

### Conclusion: China's stance with the TPP

For China, the ultimate decision to join the TPP is more of a political than an economic question since it will be reduced to comply with the established US-led TPP terms. The notion of economic independence and sovereignty is a factor, which could not be ignored during an FTA negotiation process. An economic integration treaty would inevitably disturb the political process of a sovereign, including the US and other TPP participants. Hence, whether the TPP could be accepted as currently intended among interested states requires more patient observation.

Therefore, China should wait for a better time to join the TPP negotiations, as a successful TPP calls for China's participation. If, as history suggests, the TPP is not well received by intended member states, China would be in a comfortable position to extend its economic leverage for the norm-setting powers, and to convert the TPP into an FTA according to a set of compromised terms, if not China's terms. It may lead to the rise of a politically driven, divergent dual track: China taking the lead through the Asian (EAFTA and the Comprehensive Economic Partnership for East Asia) track and the US taking the lead through the TPP track. An opaque, regulatory-coercive and membership-inclusive TPP track is therefore an alternative to the existing "soft integration" in the Asian-Pacific region. Inevitably, there will be competition between the two tracks; however, as a matter of acceptance and sustainability, China may still maintain its currently significant role in the Asian economy, and may strategically respond to any challenges posed from the US-led TPP.

### 5.2.3. Mega-regionals – How “Mega” Will Their Impact Be for Latin America? – Beatriz Leycegui

Given the “mega” nature of the TPP and the TTIP under negotiation, it is worth reflecting on Latin America's interest in these agreements and their potential significance for the region. Determining the degree of interest or impact among Latin American countries in these processes is complex, since there are many elements to consider, including the following that are addressed: whether they have trade agreements with TPP or TTIP negotiating parties and how important those markets are for their exports; and their degree of participation in these mega-regionals.

#### How close and relevant are the relationships?

As reflected in Table 3, the trade agreements network of Latin America with the EU is stronger than that with the Asian TPP countries. Practically all Latin American countries either have an FTA with the EU or are negotiating one (i.e. the Southern Cone Common Market or Mercosur) and a number of them have FTAs with the US and Canada. In contrast, except for Chile that has FTAs with many of its Asian TPP negotiating partners, virtually all other Latin American countries do not currently have preferential access to Asian TPP partners.

The same holds true for export flows, as seen in Table 4: Latin American exports to the EU (12.5% of their total export share) are on average three times bigger than their exports to the TPP Asian countries (4.1% of their total export share).

The numbers above explain why the main interest for a number of Latin American countries (e.g. Mexico, Colombia and in Central America) in the TPP and TTIP derives from their current preferential access, since they have FTAs with the US and have important exports to that country. Nearly 40% of Latin America's exports are sold to the US, and in the case of Mexico, almost 80%.

For Mercosur members (which, do not have FTAs with the US), the foreseeable market access preferences that the EU could grant to US agricultural products under a TTIP would affect their competitiveness in such a privileged market. Furthermore, as CEPAL notes, Argentina, Venezuela, Brazil and Uruguay will be further affected by the “loss of Generalized System of Preferences (GSP) benefits in the European Union, as a result of being classified for three consecutive years as upper-middle income countries by the World Bank.”<sup>53</sup>

**Table 3.** Free Trade Agreements between Latin American Countries and Negotiating Parties of the TPP and the European Union

Latin America	TPP Negotiating Parties	EU
Mercosur (Argentina, Brazil, Paraguay, Uruguay, Venezuela)	✓ (Chile, Peru)	✓ <sup>1</sup>
El Salvador, Honduras, Guatemala, Nicaragua	✓ (Chile, Mexico, US)	✓
Bolivia, Ecuador, Venezuela	✗	✗
Chile	✓ (Australia, Brunei, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, USA, Vietnam)	✓
Colombia	✓ (Canada, Chile, Mexico, USA)	✓
Costa Rica	✓ (Canada, Chile, Mexico, Peru, Singapore, USA)	✓
Mexico	✓ (Canada, Chile, Japan, USA)	✓
Panama	✓ (Canada, Chile, Mexico <sup>3</sup> , Peru, Singapore, USA)	✓
Peru	✓ (Canada, Chile, Japan, Mexico, Singapore, USA)	✓

1) Under negotiation (process resumed in 2010)

2) Signed but not in force

3) Under negotiation with Mexico

Source: Table prepared with information primarily from OAS (2013) “Trade Agreements by Country” available at [http://www.sice.oas.org/agreements\\_e.asp](http://www.sice.oas.org/agreements_e.asp)

**Table 4.** Exports from Latin America to TPP and TTIP Countries (2012)

(In millions of \$)

Latin American Countries	TPP Negotiating Countries <sup>1</sup>				TTIP Negotiating Countries <sup>2</sup>			
	TPP countries (excluding American countries) <sup>3</sup>		TPP American countries (excluding USA) <sup>4</sup>		USA		EU	
	Value	Share of total exports	Value	Share of total exports	Value	Share of total exports	Value	Share of total exports
Argentina	\$3,689	4.7%	\$9,817	12.5%	\$3,914	5.0%	\$11,268	14.4%
Bolivia	\$563	4.8%	\$1,000	8.6%	\$1,716	14.7%	\$655	5.6%
Brazil	\$13,862	5.8%	\$14,100	5.9%	\$26,701	11.1%	\$48,392	20.2%
Chile	\$10,314	13.4%	\$4,209	5.5%	\$8,986	11.7%	\$11,848	15.4%
Colombia	\$1,064	1.8%	\$5,071	8.5%	\$21,733	36.2%	\$8,949	14.9%
Costa Rica	\$403	3.6%	\$426	3.8%	\$4,167	37.0%	\$1,967	17.5%
Ecuador	\$876	3.7%	\$4,211	17.7%	\$10,587	44.5%	\$2,448	10.3%
El Salvador	\$46	0.9%	\$187	3.5%	\$2,470	46.3%	\$241	4.5%
Guatemala	\$199	2.0%	\$909	9.0%	\$4,099	40.5%	\$672	6.6%
Honduras	\$62	1.3%	\$156	3.3%	\$2,163	45.5%	\$1,226	25.8%
Mexico	\$4,819	1.3%	\$14,718	4.0%	\$287,814	77.6%	\$22,031	5.9%
Nicaragua	\$44	0.9%	\$820	17.4%	\$2,065	43.8%	\$330	7.0%
Panama	\$16	1.9%	\$136	16.6%	\$161	19.6%	\$179	21.8%
Paraguay	\$151	2.1%	\$442	6.1%	\$143	2.0%	\$1,060	14.6%
Peru	\$2,838	6.2%	\$5,848	12.9%	\$6,049	13.3%	\$7,446	16.4%
Uruguay	\$84	1.0%	\$562	6.4%	\$324	3.7%	\$976	11.2%
Venezuela	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Total</b>	<b>\$39,032</b>	<b>4.1%</b>	<b>\$62,613</b>	<b>6.5%</b>	<b>\$383,093</b>	<b>39.9%</b>	<b>\$119,690</b>	<b>12.5%</b>

1) Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, Vietnam, Canada, Chile, Mexico and Peru

2) USA and the EU

3) Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam

4) Canada, Chile, Mexico and Peru

N/A = Not available

Source: Table prepared with information from the Inter-American Development Bank, 2012

### Advantages of being a party

Chile, Mexico and Peru are the only Latin American countries that are part of the TPP negotiations. Their major interests in it are:

- Strengthening their economic ties with their Asian TPP partners and consequently with Asia-Pacific. At the same time, the TPP can contribute to constructing a trans-Pacific free trade area among APEC economies and other possible Latin American partners with coastlines on the Pacific Ocean (Central America, Colombia and Ecuador).
- Increasing their participation in regional value chains by connecting their existing FTAs with the new partnerships evolving under the TPP. Specifically, through cumulation of origin, the parties could increase the suppliers of inputs to include those from all member countries of the TPP and the final exported goods would have access to TPP partners with a tariff preference.
- Compensating tariff preference erosion by obtaining concessions from new competitors that are also part of the TPP. Of particular interest, as a result of a TPP, Japan, Brunei, Malaysia, New Zealand and Vietnam would gain preferential access to the US.

- Potentially taking advantage of reopening pre-existing FTAs to improve or update them (e.g. rules of origin, disciplining the use of trade remedies, and improving the dispute settlement mechanisms). So far, there has been little space to revisit prior commitments. However, towards the end of the TPP negotiations, this could occur to obtain the proper balance among concessions.
- Expanding cooperation in new areas such as SMEs, education, research, science and technology, among others.

For the majority of Central American countries and Colombia, becoming part of the TPP could be important because of their trade interests with the US, sharing as a result many of the interests of Chile, Mexico and Peru. However, for Latin American countries that are less dependent on the US, have a relatively small trade relationship with TPP Asian countries and have inward-oriented or closer economies, the TPP is less attractive (such as Brazil, Argentina and Bolivia).

Regarding the TTIP, so far, the only Latin American country that has requested to be part of the negotiation is Mexico. Having received the same petition from Canada, and possibly from other EU trading partners if Mexico and Canada were incorporated, the US and the EU have decided to close the door to additional participants. The complexity of the negotiations is also a reason for the TTIP negotiating parties' reluctance to invite others to the table. As a consequence, Mexico has initiated negotiations with the EU to deepen its existing FTA, with the idea of eventually seeking convergence of the negotiation processes, at least with respect to cumulation of origin.

If the TTIP were to include cumulation of origin with common Latin American FTA partners, this would have a significant impact for the region as it would diminish trade-diversion effects and take trade relations to a higher level. This is certainly a difficult scenario to think about at this time, given the overall complications of the bilateral trade agreement negotiation in itself, but the thought should be presented and well analysed. In addition and taking it two levels higher, if multilateral negotiations do not progress with the ambition that present times require and if the TTIP becomes a reality, the TTIP could eventually converge with NAFTA, the Central American FTA and other FTAs that the US and the EU have in common with Latin America. This would create one of the biggest mega-regional agreements with unforeseeable effects to the trading system.

## Conclusion

The TTIP and the TPP represent risks and opportunities for Latin American countries. A real assessment of both agreements will only be possible once they are concluded. In 1960, Latin America began an unsuccessful race to achieve economic integration. Today, less than 20% of trade in Latin America is intraregional. This is the result of strong ideological differences within the region. A recent attempt at further integration that has captured the attention of the international community is the Pacific Alliance.

## Box 4 – The Pacific Alliance

Colombia, Chile, Mexico and Peru negotiated the Pacific Alliance to achieve the awaited regional integration among like-minded countries that share the idea of trade liberalization and the need to strengthen Latin American links with the Asia-Pacific region. Together, the countries of the Pacific Alliance include more than 200 million people with favourable business environments.<sup>(1)</sup>

While intra-bloc exports are low (not more than 5%) and the added value of Pacific Alliance inputs in each country's exports is small (12% in the case of Peru, 10% in Colombia and Chile, and close to 2.5% in Mexico), as a consequence of the significant commitments described there is great potential for further integration of their value chains in sectors such as mining, chemical, textile and apparel and agroindustry.<sup>(2)</sup>

All member countries of the Pacific Alliance are FTA partners between themselves. Therefore, the objective was to go beyond their existing FTAs, contemplating among other benefits:

- Total trade liberalization (immediate for 92% of trade in goods and 8% in a tariff reduction schedule until 2030; applicable to less than 10 products which in certain cases had been excluded or had limited access in prior agreements)
- Practically complete harmonization of rules of origin being able to cumulate origin in their production processes (one of the most significant contributions)
- Trade facilitation through connecting each country's single window for trade operations and electronic certificates of origin, among other customs cooperation measures
- Regulatory cooperation through promoting mutual recognition agreements of technical standards
- Elimination of visa requirements
- Cooperation on many fronts (opening of common embassies and trade and investment promotion agencies; environment and climate change, science and technology, tourism and scholarship programmes for academic exchanges)

These benefits were incorporated in a memorandum of understanding signed in 2011 as well as in the Protocol to the Pacific Alliance Framework Agreement that its members entered into on 10 February 2014. Given its level of ambition, the Pacific Alliance has caught the attention of the international community, and hence the number of countries accepted as observers has grown significantly: Costa Rica, Panama, Australia, Canada, New Zealand, Spain, Uruguay, Guatemala, Japan, China, Portugal, Paraguay, France, Turkey, South Korea, Honduras, United States, Ecuador, El Salvador, Dominican Republic, Finland, The Netherlands, India, Israel, Italy, Switzerland, Germany and the United Kingdom.

(1) According to the World Bank's Doing Business 2013 Report, the members of the Alliance are the top four countries in Latin America with a greater ease of doing business.

(2) Perspectives of Production Integration among Pacific Alliance Countries (preliminary version), Inter-American Development Bank, April 2013, pp. 4, 10, 22-32.



Hopefully, the Pacific Alliance agreement could grow in participation to include not only more Latin American countries, but also other countries that have expressed interest in participating as observers. Being an integrated region will significantly help Latin America to have greater leverage to negotiate vis-à-vis other regions; successfully integrate into global and regional value chains; and resolve many common economic, social and political challenges. Asia-Pacific and the European Union continue to successfully work in such a direction. What is Latin America waiting for?

# 6. Facilitating the Relationship between Mega-regionals and the Multilateral Trading System – Robert Lawrence

In this section, measures are proposed that could help ensure that mega-regional agreements complement rather than undermine the multilateral trading system. The measures are of three types: first, those that should be implemented by the parties to the agreements; second, information on, and assessments of, these agreements that could be provided by the WTO and others; and third, measures that could strengthen the role and maintain the centrality of the WTO in the trading system.

## Crafting open mega-regionals

The specific rules enacted in the mega-regional agreements will be crucial in determining whether they contribute to a global economy that is more fragmented or more integrated. The participants in these agreements should be crafting these agreements with the broader implications for the system in mind.

On the one hand, they can conclude agreements with exclusive and closed memberships that provide preferences for the members and create higher barriers for outsiders. For example, such agreements might include (i) restrictive rules of origin that create disincentives for using intermediate inputs of non-members; (ii) preferential treatment to signatories in regulatory and other provisions; and (iii) extending mutual recognition of member standards only for goods and services produced in the member countries rather than any goods (even those from third countries) that meet the standards of any member of the agreement.

On the other hand, participants could contribute to a more open multilateral trading system with agreements that are open to additional members and that create more integrated and contestable markets, not only for firms based in the member countries but also from countries not party to the agreement. This would occur, for example, if a mutual recognition agreement allowed firms from non-member countries to meet the standard of any one of the members, in order to sell throughout the region. Contributions to a more open system might also be made if mega-regionals implement general rules that improve regulatory transparency

and allow full participation by all foreign firms (not only those from signatory countries) in the development of standards, liberalize services on a MFN basis and adopt trade facilitation measures that apply to all their trade.

The potential integrative benefits not only need to be an incidental outcome of the mega-regionals, but should be consciously cultivated by those concluding the agreements. The line of least resistance in the TTIP, for example, would be to negotiate another unique set of rules that covers only the agreement and would be overlaid on the rules of origin that govern the US and EU agreements with others. But, instead, the TTIP could help unravel the spaghetti bowl of rules of origin if the TTIP rules were then applied to all other regional agreements signed by the US and the EU. Indeed, implementing the same rules of origin (and allowing for diagonal cumulation) in all regional agreements in which either the US or the EU participate would achieve far more conformity than anything the WTO could feasibly achieve.

## Exchanging information and assessments of regional agreements

The WTO rules for preferential trade agreements, as expressed for example in GATT Article XXIV, relate only to tariffs and are silent on many of the issues covered by mega-regionals. Moreover, even when it comes to the rules that have been agreed to, oversight by the WTO has been extremely weak. It is unlikely that an agreement that now seeks to impose stronger enforcement of existing rules is politically feasible.<sup>55</sup> Nonetheless, either the WTO or, where more appropriate, specially designated official institutions and/or think tanks should be playing an active role in encouraging arrangements that lead to a more open international trading system. This should be achieved by improving transparency, exchanges on best practices and reviews of the systemic impacts of these agreements.

*RTA Exchanges.* Members are required to notify the WTO when they conclude agreements, but the WTO could do far more to facilitate the exchange of information and ideas of best practice. Many preferential arrangements

are simultaneously being negotiated with agreements implementing different solutions to similar problems. The WTO has a potentially valuable role to play, not only in diffusing the information it is given, but also in generating its own reviews to help members and other stakeholders keep up with developments and adopt best practices.

Suominen (2013), for example, has proposed the creation of an “RTA Exchange”, a first-in-class global clearing house of information on RTAs, and a virtual international discussion forum on ways to leverage RTAs for broader and deeper global trade integration. The exchange could include dialogues and the provision of best practice templates for inclusion in agreements. The WTO could either operate such an initiative or contribute to it by expanding its own trade policy review mechanism to cover major regional agreements in addition to the reviews it currently undertakes on the trade policies of individual members.

*Multilateral-system impact statements.* In the United States, federal policy-makers are encouraged to take account of the environmental impacts of their actions, by requiring all qualifying measures to be subject to an environmental impact statement. The purpose of these exercises is not necessarily to prevent the measures from being implemented, but rather to raise awareness and to encourage policies that minimize environmental impact. Similar awareness should be raised to encourage negotiators of regional arrangements to design agreements that would (a) create contestable markets that provide benefits to outsiders as well as participants, and (b) serve as the modular components of a more integrated global trading system.

One mechanism for doing this would be for the WTO or alternatively an independent authoritative body – either a think tank or distinguished panel of trade authorities – first to lay out a set of relevant criteria and then to apply these to an analysis of regional agreement. Ideally, suitable methodologies and criteria would be widely available, and it should become standard practice for drafts of agreements to be analysed prior to being finalized so that negotiators would be given opportunities to correct major deficiencies.

### Restoring WTO centrality

The successful conclusion of the deep mega-regional agreement currently under negotiation presents a fundamental challenge to the WTO’s role as the centre of the global trading system. With the WTO requiring consensus for its agreements, the countries that are unwilling to embark on deeper initiatives can block the institution from incorporating them effectively. As a result, the WTO rules will be the lowest common denominator while the really meaningful agreements are undertaken through mega-regionals. With the exception of the TRIPs agreement, as evidenced by the fate of the Singapore Issues, the drive towards agreements that entail deeper integration has been thwarted at the WTO.

Many members are not prepared to adopt binding commitments in policy areas such as investment, competition policy and harmonization (or mutual recognition) of standards. However, as is clear from the large number of members currently participating in the mega-regional negotiations, there is considerable demand for agreements that achieve far more than all WTO members are willing to accept. If the WTO fails to accommodate these needs, it risks losing its relevance for these members.



However, the WTO could restore its centrality by moving towards a variable geometry, in which obligations to which all members adhere are complemented by deeper open plurilateral agreements that members are obliged to join. These plurilaterals could, in fact, build on the achievements of the mega-regionals by using innovations made in mega-regional agreements as models for negotiating plurilaterals with broader WTO membership. Regional arrangements can be valuable in their own right and appropriate to reflect the unique needs of particular groups of countries, but they can also help advance progress towards a global system, in which needs that are more universal are achieved through the WTO. The WTO 9th Ministerial Conference held in Bali and the discussions that have followed may have created momentum to advance on the multilateral front.

## Box 5 – The Bali Momentum – Alejandro Jara

Many commentators have made the point that the number and size of preferential trade agreements has increased because of, among other things, the political crisis that has prevented the Doha Development Round from entering its concluding phase.

While this statement has to be tested empirically, it has become conventional wisdom. As such, it has a political impact of its own, despite the fact that preferential trade agreements do not address a number of highly sensitive trade issues that can only be dealt with in a multilateral context. Such is the case of agriculture export subsidies and domestic support, fisheries subsidies and anti-dumping measures. These areas are extremely sensitive, in terms of the highly organized sectors that defend the status quo. Since there is no perfect symmetry between the agendas of the Doha Development Agenda (DDA) and the preferential trade agreements, the effect of the stagnation of the DDA can only be said to be relative. In other words, to the extent that preferential agreements do not touch upon these sensitive areas, they appear to be easier to negotiate and command a wider degree of approval of stakeholders in key jurisdictions.

However, the idea of a stalled or dead DDA has now changed after the recent success achieved at the WTO's Ministerial Conference held in Bali (December 2013), that achieved a few substantial and valuable results, particularly on trade facilitation. This has demonstrated not only that the system can deliver and in a substantial manner, but also that there is now political momentum that WTO members are using to establish a credible programme and process to conclude the DDA.

The mega-regional negotiations take up a lot of energy (human resources and political) that could be otherwise used in concluding the DDA, and could therefore be considered as being exclusive processes. However, a closer analysis reveals important synergies and complementarities that are highlighted with the prospect of concluding the DDA. For example:

a. The DDA would bring results that would not be part of any preferential trade agreements, thus helping the latter to achieve a better balance of results (agricultural subsidies and domestic support, fisheries subsidies, and anti-dumping).

- b. Several WTO members will only pursue further trade liberalization, bilaterally or otherwise, if a rebalancing of the WTO is achieved, particularly with regards to issues such as agricultural trade-distorting subsidization.
- c. DDA results would certainly help reduce the discrimination that affects countries that, for whatever reason, do not participate in preferential trade agreements.
- d. Mega-regionals can certainly pave the way for new and better disciplines to be multilateralized sooner or later (regulatory coherence, state-owned enterprises, etc.).

# 7. Thinking about Failure – Gary Hufbauer

Success in the TPP and TTIP negotiations cannot be taken for granted. Nor, for that matter, can we be confident that big bilateral deals will be concluded – the EU-Japan, EU-China, and CJK FTAs. Each one of these agreements, but particularly the two mega-regionals, faces tremendous obstacles. The Free Trade Agreement of the Americas, which crashed and burned in 1998, serves as a reminder that failure is always an option.

Starting with the TPP – the mega-regional most likely to succeed – the biggest obstacles are found in Japan and the United States. The implicit belief harboured by several TPP members that Japan is able and willing to significantly liberalize agriculture and services may prove too optimistic. Prime Minister Abe might face a revolt in his Liberal Democratic Party constituency at the prospect of freer trade in rice, beef and pork, much less an opening to Wal-Mart and Target. But agricultural and service exporters within the TPP will threaten to walk if Japan does not meaningfully reduce its barriers, and the list of potential naysayers includes Australia, Canada and the United States.

Meanwhile, the fate of the TPP remains uncertain in the US Congress. A majority of Democratic Representatives in the House oppose the TPP, and for that matter, almost any trade agreement. On this occasion, they are nailing their flag to a currency chapter, and even if a chapter with that title is agreed by the parties, it seems unlikely that the fine print will satisfy sceptical Democrats. To compound the Congressional hurdles, a significant minority of Republican Representatives may oppose the TPP, because industries in their districts would face unwelcome import competition in sensitive agricultural products, in textiles and apparel, and in other light manufactures.

Turning to the TTIP, leaving aside the National Security Agency and the flap over digital espionage, three roadblocks can be identified. First is the sheer complexity of the deal. As President Obama loses steam and as the European Commission acquires new faces (in November 2014), it can be questioned whether leaders have the necessary stamina. Second is the opposition of independent regulatory agencies, both to common standards and to mutual recognition. These agencies are akin to the fiefdoms that dotted Europe in the Middle Ages. Unlike the fiefdoms, the regulatory agencies may not be able to preserve their independence for centuries, but they may be able to hold out for years. Third is the strong opposition of states to federal mandates either to

open procurement or to harmonize product regulations and professional standards.

If the two mega-regionals either fail outright or turn into political show horses rather than economic work horses, and if the WTO stumbles as a serious negotiating forum, the years 2013-2015 might well be called the Great Turning Point in post-Second World War policy liberalization. Bilateral FTAs will still be concluded – even big ones, such as EU-Japan and perhaps EU-China. And many countries will realize that unilateral liberalization is a great way to join GVCs and attract foreign direct investment. But multilateral or mega-regional deals that cover a third of the world economy or more will seem like a thing of the past.

In such a world, powerful forces might carry trade in goods and services, as well as foreign direct investment, to fresh heights as a percentage of world GDP. The logic of applying existing technology to foreign markets will not disappear, and new global value chains will continue to link national producers. But fresh policy liberalization, on the scale enjoyed from 1950 to 2000, will be absent from this picture. In this setting, it seems unlikely that global trade and investment can serve as the great drivers of world growth and prosperity that they were in the half century after the Second World War.

# Appendix

**Table 5.** Overview of Trade Agreements Mentioned in the Report

	Association of Southeast Asian Nations	ASEAN +3	Regional Comprehensive Economic Partnership (also ASEAN +6)	Transpacific Partnership	Transatlantic Trade and Investment Partnership	Pacific Alliance	CJK
	ASEAN	ASEAN +3	RCEP	TPP	TTIP		
European Union							
Australia							
Canada							
New Zealand							
United States							
Brunei							
Cambodia							
China							
India							
Indonesia							
Japan							
Laos PDR							
Malaysia							
Myanmar							
Philippines							
Singapore							
South Korea <sup>1</sup>							
Thailand							
Vietnam							
Chile							
Colombia							
Costa Rica							
Mexico							
Peru							

<sup>1</sup> South Korea is not part of the TPP 12, but currently in accession talks (see section 5.2.2).

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<sup>1</sup> GATT Article XXIV.

<sup>2</sup> WTO (2014). "Overview of Developments in the International Trading Environment – Annual Report by the Director-General – WT/TPR/OV/16", 31 January.

<sup>3</sup> UNCTAD (2013). "World Investment Report". "Other IIAs" refers to "agreements, other than BITs, that include investment-related provisions or investment chapters in economic partnership agreements or FTAs."

<sup>4</sup> OECD (2003), Regionalism and the Multilateral Trading System, OECD Publishing

<sup>5</sup> ASEAN members are: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

<sup>6</sup> Baldwin, R. (2014). "Multilateralising 21st Century Regionalism". OECD Global Forum on Trade, Paris, 11-12 February.

<sup>7</sup> Source: WTO (2014). "WT/TPR/OV/16", obtained from the World Bank's World Development Indicators, WTO Statistics and UNSD Comtrade database.

<sup>8</sup> In the case of TPP, such a "hub" is confirmed for two of its parties, the US and Japan, and for the TTIP parties, as measured in calculations using GTAP databases for 2001, 2004 and 2007 and indicators developed by Arjan Lejour, Hugo Rojas-Romagosa and Paul Veenendaal in CPB Netherlands Bureau for Economic Policy Analysis (2012). Discussion Paper 227.

<sup>9</sup> According to R. Baldwin, reverse trade diversion implies that, while the preferences increase trade among the partners, RTA imports from excluded nations also rise – just not as much (see Baldwin, R. section 4.2, The Economic Impact).

<sup>10</sup> With the exception of the boxes, the following subsection is based on and borrows from P. Draper, S. Lacey and Y. Ramkolowan (2014), "Mega-regional Trade Agreements: Implications for the African, Caribbean, and Pacific Countries", a report submitted to the ACP MTS programme.

<sup>11</sup> Cheong, I. "Negotiations for the Trans-Pacific Partnership Agreement: Evaluation and Implications for East Asian Regionalism", July 2013, available on the ADBI website: <http://www.adbi.org/files/2013.07.11.wp428.trans.pacific.partnership.east.asian.regionalism.pdf> (visited on 3 January 2014).

<sup>12</sup> China and the US discussed the possible addition of China to the TPP at the June 2013 Strategic and Economic Dialogue and the Sunninglands Summit between Presidents Obama and Xi Jinping. As of April 2014, China had not taken the step formally, but officially stated that it maintains an "open mind" with regards to the group.

<sup>13</sup> Williams, B. R. "Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis", 10 June 2013. Available at: <http://www.fas.org/sgp/crs/row/R42344.pdf> (visited on 3 January 2014).

<sup>14</sup> Cheong, I. op. cit.

<sup>15</sup> Draper et al., P10-11.

<sup>16</sup> Buiters, W. and E. Rahbari. "Trade Transformed: The Emerging New Corridors of Trade Power", October 2011. Citi GPS, available at: <https://www.citivelocity.com/citigps/ReportSeries.action?recordId=1> (visited 22 March 2014). Also, A. Lejour, H. Rojas-Romagosa and P. Veenendaal in CPB Netherlands Bureau for Economic Policy Analysis (2012), Discussion Paper 227. Available at: <http://www.cpb.nl/sites/default/files/publicaties/...rected-trade-val.pdf> (visited 22 March 2014).

<sup>17</sup> Cheong, op. cit.

<sup>18</sup> Ibid.

<sup>19</sup> Petri, P. A. and M. G. Plummer, "The Trans-Pacific Partnership and Asia-Pacific Integration: Policy Implications", June 2012. Available at: <http://www.iie.com/publications/pb/pb12-16.pdf> (visited 5 January 2014).

<sup>20</sup> South Korea, already a candidate in accession talks, may not become a party before the agreement among the TPP-12 is finalized, but will likely join soon thereafter.

<sup>21</sup> European Commission website "In Focus: Transatlantic Trade and Investment Partnership (TTIP)". Available at: <http://ec.europa.eu/trade/policy/in-focus/ttip/> (visited on 3 January 2014).

<sup>22</sup> Fontagne, L., J. Gourdon, S. Jean (2013). "Transatlantic Trade: Whither Partnership, Which Economic Consequences?" CEPII Policy Brief No. 1, September 2013. Centre d'Etudes Prospectives et d'Informations Internationales (CEPII).

<sup>23</sup> Francois, J. et al. "Reducing Transatlantic Barriers to Trade and Investment, An Economic Assessment", March 2013. Available on the EU website: [http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc\\_150737.pdf](http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf) (visited on 3 January 2014). This study also takes into account the potential impact of "regulatory spillovers", distinguishing between regulatory spillovers (trade costs for third countries exporting to the EU or the US fall as regulations are harmonized) and indirect spillovers (third countries begin to adopt the standards and regulations set by the EU and the US through the TTIP).

<sup>24</sup> Op. cit.

<sup>25</sup> Felbermeyer G. et al. "Transatlantic Trade and Investment Partnership (TTIP), Who benefits from a free trade deal?" June 2013. Available on the Bertelsmann Institute website: <http://www.bfna.org/sites/default/files/TTIP-GED%20study%2017June%202013.pdf> (visited on 3 January 2014).

<sup>26</sup> European Commission. "Transatlantic Trade and Investment Partnership, The Economic Analysis Explained", September 2013. Available at: [http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc\\_151787.pdf](http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc_151787.pdf) (visited on 3 January 2014).

<sup>27</sup> The "pivot" to Asia policy contains an economic element, centred on TPP, and a military one, focused on "rebalancing" US forces towards Asia. Democrats and Republicans in the US differ only in the emphasis they place on the two core elements of the American pivot. Democrats tend to focus on the TPP, with its implications for economic interdependence as the basis of international relations, while Republicans tend to emphasize military power. Both agree on the importance of Asia.

<sup>28</sup> Assessment is inspired in work done at the OECD by Iza Lejárraga and colleagues at the Trade and Agriculture Directorate of the OECD. Analysis at ICTSD by Christophe Bellmann, Ricardo Meléndez-Ortiz and Harsha V. Singh.

<sup>29</sup> Examples of the treaties listed include the Paris Convention for the Protection of Industrial Property, and the Berne Convention for the Protection of Literary and Artistic Works.

<sup>30</sup> The EU-India agreement, for example, excludes many of the deeper disciplines in the EU's other RTAs.

<sup>31</sup> See more detailed arguments on this point in Baldwin (2008).

<sup>32</sup> Sub-Saharan Africa is treated with limited reference to the region's largest and most diversified economy, South Africa, which is discussed in a separate box. The paper focuses on the TTIP and TPP, although the impact of the Regional Comprehensive Economic Partnership on international production networks is considered.

<sup>33</sup> As Stoler (2013) indicates, "While the agreements promise to eliminate tariffs, all are focused more importantly on dealing with the behind-the-border regulatory and other issues that are of greater concern to business in the 21st century. Most of the behind-the-border questions would be addressed through so-called 'WTO-Plus' commitments, meaning that they either deal with issues beyond the scope of today's WTO coverage or take a WTO-covered subject and employ a different approach that produces a superior result in a regional agreement."

<sup>34</sup> China is at present adopting a "wait and see" strategy and has not closed the door on potentially joining the TPP at a later stage should the myriad of domestic interests that influence Chinese trade policy push the executive in that direction. The US attitude to future Chinese membership is ambivalent and will be guided by Beijing's economic reform process.



<sup>35</sup> There are tremendous variations between African economies with regard to their dependence on EU, US or Chinese export markets. Furthermore, Nigeria and South Africa combined account for roughly 50% of the region's total exports.

<sup>36</sup> Under WTO rules, the Generalized System of Preferences (GSP) allows for non-reciprocated preferential treatment for products originating from developing countries, with an expanded list of items for countries classified as LDCs. Since the initiation of the GSP in 1976, only two African countries have graduated from LDC status: Botswana and Cape Verde. EBA falls entirely under the GSP-LDC regime while the US was granted a WTO waiver to extend AGOA preferences to non-LDCs. China also offers its own GSP for African countries.

<sup>37</sup> In 2012, petroleum products accounted for 86% of overall AGOA imports.

<sup>38</sup> EU and US policy approaches to bilateral relations with sub-Saharan Africa are increasingly inclined towards reciprocity. Furthermore, existing schemes have been designed to accommodate protectionist interests in key sectors, which would require considerable political resolve to confront.

<sup>39</sup> African manufacturing accounts for a mere 1% of global manufacturing value added. The share of manufacturing in the GDP has fallen sharply in many sub-Saharan African economies over the past two decades due to low levels of productivity and intensified competition from Asian producers.

<sup>40</sup> A sector of importance to sub-Saharan Africa's industrial potential that will be subject to trade diversion is textiles and clothing, given the presence of major supplier and buyer nations in the TPP and RCEP, as well as US insistence on including a "yarn forward" clause in the TPP.

<sup>41</sup> As Antoni Esteve de Aranda et al. (2013) called attention to: "While there is no obligation to mitigate preference erosion, this could be accomplished by explicitly including mechanisms for expanding cumulation to third parties. (...) Such a mechanism would allow such third countries to participate in the GVCs that span these economies, gaining benefits instead of being cut out. Where both the US and the EU have already granted duty-free access to materials from these countries, it seems particularly unreasonable to exclude them from bilateral value chains."

<sup>42</sup> For example, as Sherry Stephenson notes in her contribution on the impact of the mega-regionals on the Asia-Pacific region "A successfully completed RCEP with significant market-opening disciplines, especially in the services area, should help to expand the operation of current value chains further into South-East Asia through greater involvement of the ASEAN members, potentially including part of the Indian economy as well. These potential future implications of the mega-regionals should be a major source of worry for countries outside the Asia-Pacific region, as it will likely make it more difficult for them to break into and participate in these supply chains."

<sup>43</sup> The FTA, launched in 2011, is seen as an important step towards the African Union's ambition of reaching a Continental Free Trade Area by 2017, although this deadline should be treated with caution given the obstacles involved. The Tripartite would integrate 26 countries and cover a population of 600 million with a combined GDP of around \$1,000 billion. However, negotiations are already behind schedule due to disagreements over rules of origin and sensitive products.

<sup>44</sup> The sensitive sectors between these two participants include food categories of rice, beef and pork, dairy products, wheat and sugar, where the US is pressing for greater tariff reductions, as well as the motor vehicles sector, where Japan is trying to obtain further concessions. See Gary C. Hufbauer (2013).

<sup>45</sup> The pilot study on a possible FTA between China and the United States is being prepared by the Peterson Institute for International Economics and should be ready in the spring of 2014.

<sup>46</sup> See article on "US-China agree to re-start investment treaty talks", at <http://www.reuters.com/article/2013/07/12/us-usa-china-dialogue-trade-idUSBRE96A0ZD20130712>.

<sup>47</sup> See the Joint Statement by the EU and China put out by the EU External Action Service, found at [http://eeas.europa.eu/statements/docs/2014/140331\\_02\\_en.pdf](http://eeas.europa.eu/statements/docs/2014/140331_02_en.pdf). As a result of this meeting, the EU agreed to support China's request for participation in the TISA, or Trade in Services Agreement negotiations, ongoing in Geneva to revitalize the services area. The statement says that the EU and China consider the participation of China in the TISA negotiation as an important stepping stone towards the future multilateralization of TISA.

<sup>48</sup> The two paths towards an FTAAP have been mentioned several years in a row in the APEC Leaders' Declarations. However, the most recent APEC Leaders' Declaration of October 2013 from Bali only made reference to the FTAAP, stating: "We reaffirm our commitment to achieve a Free Trade Area of the Asia-Pacific (FTAAP), including by continuing APEC's work to provide leadership and intellectual input into the process of regional economic integration." See [http://apec.org/Meeting-Papers/Leaders-Declarations/2013/2013\\_aelm.aspx](http://apec.org/Meeting-Papers/Leaders-Declarations/2013/2013_aelm.aspx).

<sup>49</sup> Indian Express, 5 April 2014. "RCEP important agreement for India: Rajeev Kher, Commerce Secretary of India". Available at: <http://indianexpress.com/article/business/business-others/rcep-important-agreement-for-india-commerce-secy/>.

<sup>50</sup> Press Trust of India, 5 April 2014. RCEP important agreement for India: Commerce Secy. Available at: [http://www.business-standard.com/article/pti-stories/rcep-important-agreement-for-india-commerce-secy-114040401254\\_1.html](http://www.business-standard.com/article/pti-stories/rcep-important-agreement-for-india-commerce-secy-114040401254_1.html).

<sup>51</sup> See Peter Petri and Mike Plummer, "The Trans-Pacific Partnership and Asia Pacific Integration: Policy Implications", Peterson Institute for International Economics, June 2012. Available at: <http://www.iie.com/publications/pb/pb12-16.pdf>.

<sup>52</sup> ADBI Institute. Asia Pathways, 3 July 2013. "RCEP and TPP: Next stage in Asian regionalism", by Sanchita Basu Das. Available at: <http://www.asiapathways-adbi.org/2013/07/rcep-and-tpp-next-stage-in-asian-regionalism/>.

<sup>53</sup> Rosales O., S. Herreros et al. (2013). "The Mega-Regional Negotiations: Towards a New Governance of International Trade", Santiago de Chile: ECLAC-United Nations, International Trade Series no. 121, p. 49 (in Spanish).

<sup>54</sup> Leycegui, B. (2012). "Reflections on Mexico's International Trade Policy 2006-2012", Mexico City: ITAM, Ministry of Economy, p. 108 (in Spanish).

<sup>55</sup> It would be hard to obtain the required consensus to strengthen the oversight that has been provided by the WTO, but an alternative route that might perhaps be more feasible would be for a single or group of countries that have been excluded from major agreements to use litigation as a complement to negotiation by challenging agreements that adopt discriminatory provisions that have the effect of undermining previously granted concessions. Countries are clearly within their rights under Article 24 to adopt free trade agreements, but are they actually allowed to adopt rules of origin in those agreements such as yarn-forward in clothing that have the effect of closing markets to outsiders? GATT Article 23 does allow for cases relating to nullification and impairment of benefits, and it would be interesting to see if a country could challenge some of those rules under this provision.



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World Economic Forum  
91–93 route de la Capite  
CH-1223 Cologny/Geneva  
Switzerland

Tel.: +41 (0) 22 869 1212  
Fax: +41 (0) 22 786 2744

[contact@weforum.org](mailto:contact@weforum.org)  
[www.weforum.org](http://www.weforum.org)