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## **Submission to Senate Standing Committee on Foreign Affairs, Defence and Trade References Inquiry on the Trans-Pacific Partnership Agreement**

### **Executive Summary**

- The Trans-Pacific Partnership (TPP) agreement has systemic implications for the Asia-Pacific trade architecture
- The spread of bilateral FTAs during the 2000s resulted in the fragmentation of the regional trade system. This produced a number of challenges – collectively known as the ‘noodle bowl problem’ – which have threatened Australian trade interests.
- The TPP may address these problems by ‘multilateralising’ the regional trade system. It is particularly suited to this task due to its size, ambitious reform agenda and status as a ‘living agreement’.
- Australia stands to gain considerably if the TPP’s high standard approach becomes a template for multilateral trade liberalisation in the Asia-Pacific.
- Policymakers should take these systemic factors into consideration when weighing the costs and benefits of TPP accession for Australia.

### **Introduction**

The Trans-Pacific Partnership (TPP) is one of the most significant developments on both Australia’s trade and broader foreign policy agendas. Since negotiations were completed and a legal text released in October 2015, a series of lively policy debates have weighed the merits of the TPP.

Nearly all of these debates have focussed on the short-term benefits and costs of the TPP for the Australian economy. Key issues have included questions over investor-state dispute settlement (ISDS) mechanisms; the regulatory impacts of new copyright and pharmaceutical rules; the extent of market access gains (including but not solely in agriculture); and contested estimates of the expected increase in Australian exports and economic growth.

However, a critically important question has received relatively little attention: *What systemic effects will the TPP have for the trade architecture of our region?*

The TPP is more than just a set of market access opportunities that need to be balanced against the costs of domestic policy reforms. It also promises wholesale change in the way the Asia-Pacific trade system is structured. Understanding the TPP's effects on the regional trade architecture is essential if we are to properly evaluate its implications for Australia.

### **The fragmented trade architecture of the Asia-Pacific**

In the early years of the 21st century, the trade architecture of the Asia-Pacific was dramatically transformed. Regional governments were previously 'committed multilateralists' – pursuing trade liberalisation either through the WTO at the global level, or APEC at the regional level.

But the 2000s, Asia-Pacific governments' attention turned toward bilateral free trade agreements (FTAs). Simpler to negotiate than multilateral agreements, bilateral FTAs were seen as a 'quick and easy' way to open new export markets. As the WTO's Doha Round began to stall in the mid-2000s, they also presented a 'second best' trade policy strategy: to advance liberalisation on a bilateral basis while multilateral efforts were delayed<sup>1</sup>.

The Asia-Pacific quickly became the epicentre of a global move to trade bilateralism. By 2015, regional governments had signed fifty-two bilateral FTAs between themselves; in addition to fifty-five with extra-regional partners<sup>2</sup>. The Asia-Pacific is currently home to half of all bilateral FTAs in-force globally.

The proliferation of bilateral FTAs in the Asia-Pacific has led to a phenomenon trade economists call the "noodle bowl problem". Rather than having a single, integrated set of trade rules that apply equally to all governments, the region is now criss-crossed by over a hundred bilateral deals. Compounding matters, the bilateral FTAs are often wildly inconsistent. Each contains its own rules for tariff reduction, non-tariff trade policy reforms, and standards for administrative procedures. Some include rigorous implementation of rules for the so-called 'WTO-Plus' issues – such as investment, services, and intellectual property – while others include these issues in either a piecemeal fashion or not at all<sup>3</sup>.

The noodle bowl is widely considered to be bad for trade liberalisation. From the perspective of governments, it undermines the cohesiveness of trade rules. Governments must negotiate and monitor a complex set of bilateral agreements, straining the capacity of trade bureaucracies. Markets become distorted by trade diversion effects, where economies can gain (and lose) export markets due to the marginal effects of FTAs rather than underlying competitiveness factors. Small economies like Australia are at a particular disadvantage, as they lack the clout to press for meaningful outcomes when negotiating with large economies on their own<sup>4</sup>.

Business is equally affected by the noodle bowl problem. It imposes transaction costs on firms, who must ensure compliance with literally dozens of different rules. It also inhibits the development of regional production networks. For example, the automobile industry in Asia draws on technical services, raw materials and parts suppliers from a wide range of countries to enable the final

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<sup>1</sup> Christopher Dent (2010). 'Free trade agreements in the Asia-Pacific a decade on: evaluating the past, looking to the future'. *International Relations of the Asia-Pacific*, 10(2): 201-45; Barry Desker (2004). 'In Defence of FTAs: From Purity to Pragmatism in East Asia'. *The Pacific Review*, 17(1): 3–26.

<sup>2</sup> Author's compilation, from World Trade Organization (2016). Regional Trade Agreements Database. [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm)

<sup>3</sup> Jeffrey D. Wilson (2015). 'Mega-Regional Trade Deals in the Asia-Pacific: Choosing Between the TPP and RCEP?'. *Journal of Contemporary Asia*, 45(2): 345–353.

<sup>4</sup> Ann Capling and John Ravenhill (2015). 'Australia's flawed approach to trade negotiations: And where do we sign?'. *Australian Journal of International Affairs*, 69(5): 496-512.

production of vehicles. With each link in the value chain potentially subject to different trade rules, the system-wide transaction costs can be massive. The inconsistencies between different bilateral FTAs thus become a new trade barrier themselves<sup>5</sup>.

Trade economists have long understood that the noodle bowl is a major challenge facing economic integration in the Asia-Pacific. As bilateral agreements proliferated during the mid-2000s, it seemed there was little that could be done about it. However, in the 2010s policymakers have not only become aware of the problem, but have also begun to devise strategies to rectify it. These strategies typically involve ‘multilateralising’ the regional trade system by combining existing bilateral FTAs into a cohesive whole. The TPP is the first, and thus far most successful, attempt to do so.

### **The TPP as a vehicle for multilateralising the Asia-Pacific trade architecture**

An important, but often overlooked, feature of the TPP is that it is an explicit attempt to address the noodle bowl problem<sup>6</sup>. By providing a single, overarching set of trade rules with relatively broad regional coverage, it is one of the first steps in returning Asia-Pacific trade architecture to a multilateral model.

Three features make the TPP particularly suited to this task:

*The first is its size.* The TPP is one of the largest free trade agreements ever signed, and is not only of regional but global importance. The combined economic size of the 12-member bloc is USD 28 trillion, equivalent to just over one-third of world GDP. They conduct USD 9.5 trillion of two-way trade, accounting for a quarter of world trade flows. The presence of global heavyweights such as Japan and the US, alongside important emerging economies like Malaysia and Vietnam, gives the group a significant degree of geo-economic heft.

This size makes the TPP an ideal candidate for multilateralising the Asia-Pacific noodle bowl. There are currently nineteen FTAs between its members<sup>7</sup>, which account for just under half of all the bilateral FTAs in the region. While the TPP does not subsume or legally replace these agreements, it does establish a common set of trade rules amongst countries in the group. For example, it provides a single investment chapter – which defines concepts, clearly specify protections, and outline dispute settlement mechanisms – consistently across the membership. Articulating a single set of trade rules for such a large chunk of the global economy is of broader systemic importance.

*The second is its WTO-Plus approach to liberalisation.* The TPP text reflects ambitions to execute what its members describe as a “21<sup>st</sup> century trade agreement”. Unlike many bilateral FTAs, the agreement goes beyond tariff reduction to include series of trade-related policy issues that have yet to be addressed at the WTO. These provisions are summarised below. Many are new trade issues – including as e-commerce, telecommunications and services – whose importance has increased with the rise of the digital economy and service-sector trade. Others are issues which have recently emerged onto the economic policy agenda, such as environment, labour and anti-corruption measures. The TPP sets a high water mark for forms of trade liberalisation beyond the mutual reduction of tariffs.

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<sup>5</sup> Richard E Baldwin (2007). ‘Managing the Noodle Bowl: The Fragility of East Asian Regionalism’, *ADB Working Paper Series on Regional Economic Integration* (No. 7), Manila: Asian Development Bank.

<sup>6</sup> Ann Capling and John Ravenhill (2011). ‘Multilateralising Regionalism: What Role for the Trans-Pacific Partnership Agreement?’. *The Pacific Review*, 24(5): 553–575.

<sup>7</sup> Author’s compilation, from Asian Development Bank, *Asia Regional Integration Centre Free Trade Agreements Database* (<https://aric.adb.org/fta-all>).

*WTO Plus issues included in the Trans-Pacific Partnership*

| Chapter                          | Example provisions   |
|----------------------------------|--|
| Investment                       | <i>Most-favoured-nation</i> and <i>national treatment</i> protections, enforced via standardised <i>Investor-State Dispute Settlement (ISDS)</i> process                         |
| Transparency and Anti-Corruption | Requirement for members to criminalise (and sanction) corruption, and to adopt appropriate accounting, auditing and financial disclosure standards                               |
| Environment                      | Requirements for effective enforcement of national environmental law; promotion of collaborative activities in range of areas (fisheries, CITES, biodiversity, renewable energy) |
| E-commerce                       | Privacy protections; equal treatment of digital content; protections for source code   |
| Intellectual Property            | Protection of trademarks and geographical indicators; harmonisation of patent rules; life-plus-70-years standards for copyright; requirements for enforcement regimes            |
| State-owned enterprises          | Requirement for SOEs to act in accordance with 'commercial considerations' in specified circumstances; transparency rules for reporting SOEs and government monopolies           |
| Telecommunications               | Requirement for major suppliers to provide service to foreign firms on a non-discriminatory basis; transparency regulations  |
| Financial services               | <i>National treatment</i> , <i>most-favoured-nation</i> and <i>cross-border-supply</i> provisions  |
| Services                         | <i>National treatment</i> , <i>most-favoured-nation</i> and <i>market access</i> provisions  |
| Labour                           | Prohibition against weakening or failure to enforce labour standards; initiatives to discourage trade in goods made using forced or child labour                                 |

Source: Author's summary, from Department of Foreign Affairs and Trade, *Trans-Pacific Partnership Chapter Summaries* (<http://dfat.gov.au/trade/agreements/tpp/summaries/Pages/summaries.aspx>)

The TPP is a first step in ensuring regulatory coherence in these new trade policy areas. One of the main distortions introduced by bilaterals is their inconsistent approach to WTO Plus issues. By establishing a common set of rules and definitions for WTO-Plus liberalisation, the TPP can help smooth out these inconsistencies. One example is Investor-State Dispute Settlement (ISDS). Despite featuring in many bilaterals, differing ISDS implementations have resulted in a lack of clarity over precisely what rights and obligations these impose<sup>8</sup>. A particular concern has been around the definition of 'expropriation', to what extent this impacted on governments' ability to engage in public welfare regulation<sup>9</sup>. Providing a single ISDS template via the TPP can help end this regulatory uncertainty for both businesses and governments.

*The third is its status as a 'living agreement'*. The member states have made clear that the TPP is not a fixed, one-shot agreement. Rather, it is intended to be an open framework for ongoing trade policy reform. One mechanism has been the active encouragement of new member states. Negotiations initially commenced with only eight members, but Canada, Malaysia Mexico and Japan all joined during talks. Korea and Indonesia are currently considering accession arrangements, while other regional governments will be studying the details closely. If additional new members can be courted to join the TPP in coming years, this will help a push towards fuller regional coverage.

An additional mechanism is the scope for expanding and adding new provisions to the text. The TPP establishes a series of cooperation frameworks, charged with studying national policies and suggesting avenues for policy reform. For example, it creates an 'TPP Environmental Committee' tasked with improving inter-governmental policy coordination; alongside institutionalised process for consultation on intellectual property and patent issues. These mechanisms mean the TPP is likely to increase in size and scope once initial ratification is complete.

<sup>8</sup> Marta Latek (2014). *Investor-State Dispute Settlement (ISDS): State of play and prospects for reform*. EPRS Briefing, 130710REV2, Brussels: European Parliamentary Briefing Service.

<sup>9</sup> For a discussion, see Chapter Four of Senate Foreign Affairs, Defence and Trade References Committee (2014). *Report of Inquiry into the Korea-Australia Free Trade Agreement*. Canberra: Department of the Senate.

## **The TPP, regional multilateralization and Australia's trade interests**

These three features – size, WTO-Plus approach and living agreement status – mean the TPP is the first meaningful step towards addressing the noodle bowl of Asia-Pacific FTAs. In the long-term, this feature may prove far more important than the short-term market access gains on offer when the agreement initially takes force.

Australia stands to gain considerably if the TPP is able to induce a multilateralisation of the Asia-Pacific trade architecture. In the regional context, Australia is not only a very open economy, but also a very small one. Countries like Australia – which lack the size or political heft to negotiate strong bilateral agreements on their own – generally benefit from multilateral liberalisation the most. The fact that the TPP has delivered much greater outcomes than Australia's previous bilaterals<sup>10</sup> attests to the benefits that a regional approach can offer.

The WTO Plus approach embodied in the TPP is also a natural fit with Australia's trade policy interests. Many of its provisions, especially those to do with agricultural value chains and services trade, are directly relevant to areas in which the Australian economy has a comparative advantage. But these have hitherto been ignored at the WTO, and Australia's record of achieving meaningful outcomes in its bilaterals has been patchy at best. The TPP provides an opportunity to advance the type of liberalisation that Australia wants, with some of its most important trade partners.

Perhaps most importantly, Australian policymakers should recognise that the TPP is more than 'just another FTA'. Its ultimate promise lies in its ability to induce a systemic change in the regional trade architecture, away from bilateralism and towards a multilateral model that better suits Australia's trade interests. In the long-run, this systemic effect will be of far greater significance than the market access opportunities on offer when the agreement initially takes force.

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<sup>10</sup> Ann Capling and John Ravenhill (2015). 'Australia's flawed approach to trade negotiations: And where do we sign?'. *Australian Journal of International Affairs*, 69(5): 496-512.