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Trans-Pacific Partnership to Face 21st-Century Challenges

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EXECUTIVE SUMMARY

- The Trans-Pacific Partnership (TPP) is a proposed "comprehensive and high-standard" free trade agreement that seeks to eliminate tariffs and non-tariff barriers to trade in goods, services, and agriculture, and to establish rules on a wide range of issues including foreign direct investment and other economic activities.
- At the 2011 APEC Leaders Meeting in Honolulu, TPP member countries proposed the next steps in developing a "21st-century agreement" that addresses the issues of the development of small- and medium-sized enterprises, fostering supply chain competitiveness, and addressing the challenges of state-owned enterprise in the light of fair competition concerns.
- There is growing concern that the ambitious and complex negotiation process involved—as well as other emerging conflicts and difficulties faced by member states—will hamper the progress of the TPP. Even if it is concluded, the TPP may not result in the intended seamlessly integrated and well-functioning free trade area in Asia and the Pacific.

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- The TPP agreement needs to ensure inclusiveness whereby SMEs are on a par with large firms, particularly multinationals, in reaping the benefits from free trade and investment. In addition, the agreement will need to include major players in the Asia-Pacific region, such as China, to improve competitiveness of supply chains.
- Given the political and economic implications of SOEs among TPP member countries, the negotiations on the competitive neutrality provision appear to be patchy and critically hamper the progress of overall TPP negotiations. Addressing competitive neutrality in a single FTA may prove to be counter-productive in the TPP negotiations and, in many cases, cannot be implemented even among the existing TPP member countries.

INTRODUCTION

The Trans-Pacific Partnership (TPP) is a proposed “comprehensive and high-standard” free trade agreement that seeks to eliminate tariffs and non-tariff barriers to trade in goods, services, and agriculture, and to establish rules on a wide range of issues including foreign direct investment and other economic activities. Rapidly evolving and expanding since its inception in 2003, the TPP involves 12 member countries in Asia and the Pacific—Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States—with countries such as the Philippines and Thailand potentially joining the bandwagon.

The TPP negotiations are highly complex and its results are expected to have far-reaching effects. With 29 chapters in the agreement under discussion, the TPP is intended to be more comprehensive than comparable rules and provisions under GATT/WTO. As the negotiating countries include advanced industrialized, middle income, and developing economies, the TPP—if implemented—may involve substantial restructuring of the economies of some member countries. The agreement is also expected to become a potential platform for the Free Trade Area of the Asia Pacific (FTAAP) and economic integration among the 21 APEC economies.

At the 2011 APEC Leaders Meeting in Honolulu, TPP member countries reviewed the progress of the negotiations and proposed the next steps in developing the TPP as a “21st-century agreement” that addresses new and cross-cutting issues presented by an increasingly globalized economy. These issues include the development of small- and medium-sized enterprises, the fostering of supply chain competitiveness, and addressing the challenges faced by state-owned enterprise in light of fair competition concerns. There is growing concern that the ambitious and complex negotiation process—along with other emerging conflicts and difficulties faced by member states—will hamper the successful conclusion of the TPP. Even if it is concluded, the TPP may not result in the intended seamlessly integrated and well-functioning free trade area in Asia and the Pacific. This paper takes stock of the recent developments on these issues and suggests avenues on how member states can effectively address these challenges and push the negotiations forward.

STRENGTHENING SMALL AND MEDIUM ENTERPRISES

Small and medium enterprises (SMEs)—firms with official country definitions of between 100 to 500 employees—are a major driver of economic growth in Asia and the Pacific. Among TPP member countries, SMEs contribute between 48.5 to 86.0 per cent of total employment and constitute 23.0 to 56.4 per cent of GDP (see Table 1). Notwithstanding their substantial contributions, the performance gap between SMEs and large firms can be considerable in many areas, such as working capital and productivity. Competing against the major players is a challenge especially for small firms. In particular, markets dominated by giant firms with substantially higher economies of scale can be impenetrable to small businesses, which tend to concentrate on domestic markets. The competitive barriers faced by SMEs have led to efforts to improve their access to foreign markets and to the benefits that can be accrued from burgeoning regional economic integration.

Table 1: Employment and GDP Shares of SMEs in the TPP Member States, 2005.

Country	Share in Employment (%)	Share in GDP (%)
Australia	n.a.	23.0
Brunei	n.a.	n.a.
Canada	n.a.	n.a.
Chile	86.0	n.a.
Japan	71.7	56.4
Malaysia	n.a.	n.a.
Mexico	48.5	n.a.
New Zealand	n.a.	35.0
Peru	67.9	55.5
Singapore	n.a.	n.a.
United States	n.a.	48.0
Vietnam	74.2	24.0

Source: Ayyagari, et al. (2005).

Existing platforms of regional economic integration—including the North American Free Trade Area (NAFTA), Asia-Pacific Economic Cooperation (APEC), and the Association of Southeast Asian Nations (ASEAN)—also recognise the importance of boosting foreign market access among SMEs. However, little progress has been made to help these firms venture overseas and leverage on more exposure to foreign markets. This is due to the lack of access to external credits, entrepreneurship and innovation. Therefore, it is imperative for the TPP member countries to specifically address the issues of SME development by enhancing their capability to take risks and thrive on new business opportunities beyond their domestic markets.

There are at least two additional reasons why strengthening SMEs is a way forward for the TPP. First, research has shown that SMEs outperform large businesses in terms of job creation despite having a relatively small share in international trade. This may be due more to their age than their size, though. In Asia and the Pacific, the share of employment held by SMEs ranges from 50.0 to 95.0 per cent of total employment. This implies that more active participation in international trade by the SME sector may bring about increased and sustained labour employment especially since they participate in trade indirectly as suppliers, feeding parts and components in the supply chain of larger finished products that can be for export. Second, while earlier studies and popular discourse have depicted SMEs as vulnerable in times of crisis, they appear to have become more resilient to external shocks compared to large firms – the aftermath of the global financial crisis in 2008-9 witnessed the roles of SMEs as a shield against a sharp fall in export demands. During this period, those hardest hit by the global economic slump were large firms, while SMEs appeared to be relatively resilient to shocks and continued to maintain a stable level of employment, output and productivity.

The proposed agreement embraces the issue of SME development as a stand-alone chapter. While provisions related to SMEs are included in other chapters, it will be worthwhile for the chapter on SMEs to focus on SME capacity to take advantage of the enhanced trading opportunities that can be gained through the potential FTA. SMEs, in contrast to large firms, tend to have more difficulties in understanding the clauses of the agreement, getting access to information on tariff schedules and foreign regulations, and meeting prevailing standards and rules of the FTA. Given the pivotal impact of SMEs on an increasingly integrated Asia as well as the Pacific region, it is imperative to include the issue of SME development in every aspect of the negotiations. This is to ensure that firms are motivated enough to fully take part in regional economic integration.

IMPROVING COMPETITIVENESS OF SUPPLY CHAINS

Production networks, or supply chains, have become part and parcel of today's business model. This is a result of the advancement of information technology and declining transportation costs. A wide range of products–for example, textiles, computers, and jumbo jets–require parts and components procured from different parts of the globe. To date, more than 50 per cent of all non-fuel merchandise trade pertains to trade in parts and components. In Asia and the Pacific, the figure is more than 60 per cent. In the announcement of the 21st century Trans-Pacific Partnership (TPP) Agreement in 2011, the leaders of the then nine TPP countries agreed to "construct a fully regional agreement that facilitates trade and the development of production and supply chains among TPP members." While the issues affecting supply chains have already been addressed in bilateral FTAs, this declaration marks the first time in a trade agreement that issues, pertinent to the development of regional production and supply chains, are addressed holistically.

While establishing well-functioning supply chains in Asia and the Pacific has been one of the key aspirations among TPP signatories, whether the TPP member countries can achieve the set goal of improving the region's supply-chain performance by 10 per cent by 2015 is questionable. First, the goal of competitive supply chains is, by construction, contradictory with restrictive rules of origin, which essentially define those parts and components that are entitled to preferential treatment under TPP and those that are not. As a result, the potential agreement inevitably imposes administrative costs and complex custom procedures among firms leveraging on regional production networks, especially since it is highly likely that flows of parts and components will be encompassed by both TPP and non-TPP countries. The additional transaction costs arising from the discriminatory effects of TPP may also ultimately undermine the competitiveness of the region's supply chains.

More importantly, competitive supply chains in Asia and the Pacific would not have been possible without China – the largest player in the East Asian supply chains with strong intra-industry trade linkages with Southeast Asian countries as well as Japan and the United States (see Table 2). Multinational enterprises (MNEs) around the region like Apple, IBM, Sony, General Motors, and Toyota have increasingly engaged in outsourcing many parts and components to China to tap on the latter's relatively low labour cost. Since China is excluded from the TPP platform–at least politically–and the Chinese government's interest lies within a different negotiation track, i.e. the Regional Comprehensive Economic Partnership (RCEP), a more likely scenario is that China will not take part in the TPP negotiations any time soon. If this is the case, the outcome of regional initiatives is not going to be meaningful in bringing about competitive, well-functioning supply chains in Asia and the Pacific. The TPP may also eventually lose its value as a pathway toward FTAAP.

Table 2: Shares of China's Parts and Components Imports from TPP countries (per cent).

Country	1992	1993	1996	1997	2000	2001	2004	2005
Australia	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Brunei	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Canada	0.6	0.4	0.9	0.9	1.6	1.2	0.5	0.4
Chile	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Japan	20.2	32.1	35.1	32.3	25.9	24.2	20.8	17.9
Malaysia	0.1	0.3	1.5	2.1	4.5	5.4	6.6	6.9
Mexico	n.a.	n.a.	n.a.	0.4	0.6	0.8	0.6	0.6
New Zealand	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Peru	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Singapore	0.6	1.6	3.7	5.4	2.8	2.7	3.1	3.4
United States	9.6	10.3	9.8	10.9	8.5	9.4	5.8	5.5
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Li, et al. (2008).

The remedy to this problem rests critically on full participation in the TPP negotiations by China as well as other Southeast Asian players in the regional supply chains. At present, the TPP is not yet ready to fully address the issues of supply chain development because the discriminatory effects against non-member countries–given the limited number of signatories–will tend to outweigh increased efficiency of supply chains within the TPP grouping. Until the platform encompasses major, if not all, players of supply chains in the Asia-Pacific region, it remains unclear how the TPP can provide the impetus for improving the competitiveness of supply chains. Although the issue will be addressed in a stand-alone chapter as well as in other chapters covering issues related to supply chains, it will take time for the agreement to effectively address the challenges related to supply chain development.

ADDRESSING CHALLENGES OF STATE-OWNED ENTERPRISES

In the context of the current TPP negotiations, state-owned enterprises (SOEs)–businesses that are owned or influenced by a government either directly or indirectly–have the strongest presence in Vietnam; they account for approximately 40 per cent of national output. Similarly, the largest firms in Malaysia, Mexico, and Singapore are SOEs. In addition, the second and third largest firms in TPP countries are Japanese SOEs. The issue of SOEs rests mainly with their anti-competitive behaviour since they receive privileges provided by a government–such as subsidies, low-cost access to credit, and preferential access to government procurement– not enjoyed by their private counterparts. Such advantages may also be directed towards companies not owned but significantly favoured or supported by the government. Such preferential treatment imposes restrictive effects and distortions on free trade and foreign investment. As in other existing FTAs involving the United States, the anti-competitive behaviour of SOEs is addressed in the TPP through a provision known as "competitive neutrality" – a principle which ensures a level playing field between SOEs and private firms.

Given the political and economic significance of SOEs to the TPP member countries, the negotiations on the competitive neutrality provision appear to be patchy and critically hamper the progress of overall TPP negotiations. First, it is unclear how competitive neutrality in TPP can strike a balance between the free and fair practice of trade and investment and the protection of national interests. In many TPP member countries–especially Japan, Malaysia, Mexico, and Singapore–SOEs are a key arm of agricultural subsidy schemes and government investment policies (see Table 3). Given these behind-the-border constraints, competitive neutrality, is utterly unfeasible for many TPP member countries. Another impediment concerns the internationalisation of competitive neutrality. The provision of competitive neutrality proposed in TPP is in line with the existing FTAs involving the United States. The U.S.-Singapore FTA, for example, also includes several provisions dealing with national treatment, non-discrimination, and transparency, which aim to promote competition among SOEs. However, the notions of national treatment, non-discrimination and transparency vary greatly among different TPP member states, and whether or not TPP member countries can come up with and agree upon a uniform notion is clearly uncertain. Some TPP member states like the United States and Australia are strong advocates of competitive neutrality, while others like Japan, Malaysia, Mexico and, not least, Vietnam, are reluctant to pursue competitive neutrality.

Table 3: List of the Largest State-owned Enterprises (SOEs) in the TPP Countries, 2013.

Country	Company	Rankings	Profits (billion)
Australia	Commonwealth Bank of Australia	5th	7.3
Brunei	n.a.	n.a.	n.a.
Canada	Royal Bank of Canada	2nd	7.4
Chile	n.a.	n.a.	n.a.
Japan	Japan Post Holdings	2nd	6.8
Malaysia	Petronas	1st	16.0
Mexico	Pemex	1st	0.2
New Zealand	n.a.	n.a.	n.a.
Peru	n.a.	n.a.	n.a.
Singapore	Wilmar International	1st	1.3
United States	General Motors	7th	6.2
Vietnam	n.a.	n.a.	n.a.

Source: Author's compilation from Global Fortune 500, available at: http://money.cnn.com/ magazines/fortune/global500/index.html.

Given these underlying complexities and difficulties, addressing competitive neutrality in a single FTA is a daunting task and may prove to be a counter-productive goal for the TPP. Even if TPP member countries successfully endorse the competitive neutrality provision, SOEs' preferential treatments by a government can still be undertaken in many other forms which are constantly evolving and often difficult to detect. Furthermore, other existing provisions in the TPP may already adequately temper advantages for the SOEs (e.g., market access, foreign investment, and competition policies) and may suffice to mitigate—if not eliminate—inefficiencies and distortions that arise from SOEs' anti-competitive actions. Therefore, the gains from the competitive neutrality negotiations may be negligible, and it may be more appropriate for TPP member states to refrain from the issue altogether.

CONCLUSION

Current challenges to free trade differ greatly from those prevailing a decade ago. This is due to the increasingly complex and rapidly shifting economic, political and technological global landscape. While the attempt to develop the TPP as a "21st-century agreement" is admirable and imperative for achieving the ambition of FTAAP, the hiccups and delays in the negotiation process show that there remains room for improving existing provisions. Firstly, the rising role of SMEs in economic growth and sustainability suggests that the TPP agreement will need to ensure inclusiveness whereby SMEs are on a par with large firms, particularly multinationals. Secondly, the agreement will need to include the major players in the Asia-Pacific region, such as China, if it is to improve the competitiveness of supply chains. Lastly, issues related to SOEs are particularly problematic for the TPP negotiations and, in many cases, cannot be implemented even among the existing TPP member countries. Instead, competitive neutrality can be addressed in other existing provisions, and removing the issues of SOEs from the negotiations may help facilitate the conclusion and expansion of the TPP.

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