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The Trans-Pacific Partnership: market access in goods

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I. Introduction

The Trans-Pacific Partnership (TPP) negotiations got underway in earnest in March 2010 with the first round of negotiations held in Melbourne, Australia. At that time, participants included officials from Australia, Brunei, Chile, New Zealand, Peru, Singapore, and Vietnam. The seven countries were united by their desire to create a new kind of agreement—one that they claimed would be a “21st century, high quality” deal for the future (Lim, Elms, & Low, 2012).

One of the key components of such a forward-looking agreement was a comprehensive, ambitious outcome for trade in goods. This included not just deep commitments to further liberalize goods markets to one another, but also the creation of rules designed to minimize other kinds of non-tariff barriers to trade in goods. The ultimate goal for officials was to speed up and ease the flow of goods back and forth across TPP member countries. This objective was seen as particularly important in a world increasingly moving towards regional and global supply chains. Any bottleneck impeding the movement of goods across

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borders is increased in value chain settings, where goods often flow multiple times across borders before reaching the final destination.¹ For example, even very low tariffs are significantly magnified by the time the final product reaches its destination if, for example, various components are each subject to tariffs as low as two percent (Miroudot & Rouzet, 2013).

II. Complex negotiating environment

One critical problem, however, for TPP negotiators meeting in Melbourne in 2010, was the extent to which the parties were already interconnected by existing preferential trade agreements (PTAs). These bilateral and regional agreements covered nearly all the possible “pairs” of countries sitting down in the room in Australia.² Some countries were even covered multiple times under different agreements. Singapore and New Zealand, for example, were already covered under an agreement between Australia/New Zealand/Singapore (ANZSCEP), the P4 agreement with Brunei, Chile, New Zealand and Singapore, and an agreement between Australia, New Zealand and ASEAN (AANZFTA).

This complex negotiating environment with overlapping PTAs will soon become a problem in other areas. For the moment, the situation is most acute in trade in goods (Elms, 2013). This is because every PTA contains commitments in goods including tariff reductions and specific rules to decide which products “count” for receiving these benefits of lower tariffs to partner firms and which do not (called rules of origin and discussed in greater detail below). If every PTA had similar commitments for goods trade, there would not be a particular problem in making a new agreement. However, nearly all PTAs actually contain different provisions and many are in direct conflict with one another. At the most extreme, if an existing PTA carves out or specifically excludes a good from one agreement, bringing that good into the TPP would automatically negate the

¹ See, for example, the World Trade Organization’s Made in the World Initiative (MIWI) at http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm. New data on trade flows collected by the WTO and OECD reinforce this point. The joint database on trade in value added terms can be found at: http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO.

² The “missing” pairs included: Peru with Australia, Brunei, New Zealand and Vietnam; the United States with Brunei, New Zealand and Vietnam; and Vietnam with Chile (under negotiation) and New Zealand.

provision in the existing agreement (as the item would now be allowed into the partner market under the new terms).³

III. Market access for goods

Given the existence of multiple PTAs between members that all contained—at a bare minimum—commitments on market access in goods, early expectations were that negotiations over goods would proceed relatively quickly and smoothly. After all, most officials in the room had already had extensive experience bargaining over goods trade with one another.⁴ Even if the bilateral or regional deals did not ultimately resolve every disagreement over specific goods or sectors, officials knew pretty well where the “red lines” were likely to lie.

However, after nearly three years of negotiations, the market access talks represented the laggard chapters of the agreement. Rather than lead the agreement by reaching a speedy conclusion, the goods negotiations were not wrapped up by mid 2013. In fact, despite heroic efforts and marathon negotiating sessions supplemented by intercessional meetings, some goods elements, like the rules of origin chapter, were only partially completed.

The first order of business for officials interested in opening up markets to one another was to reduce tariff levels. Tariffs can be thought of as a tax on imported goods. Although the countries in the TPP negotiations have generally low tariff levels, some products are protected by a variety of mechanisms, including high tariffs for specific items or quantitative restrictions.

Goods are arranged into different categories using a Harmonized System (HS) code.⁵ HS codes can be thought of as a sorting system, with the greatest number of products bundled together at the two-digit level and more finely detailed information on products given as more digits are included. As an example, vehicles other than railway or tramway rolling stock are found at the 2 digit level, Chapter 87. Motor cars and vehicles for transporting persons are given the code, 8703, at the 4 digit level.

³ Note that the older agreements are not “revoked.” Instead, businesses are expected to migrate to using the newer, most comprehensive agreements with the best benefits to business. In effect, firms will “vote with their feet.”

⁴ If not personally, at least there was some recent, institutional memory of having done so.

⁵ The World Customs Organization manages the system and revises it periodically.

Digging down further, the code breaks down cars by engine sizes at 6 digits. For example, 870322 are Other Vehicles, Spark-ignition Engine of a cylinder capacity exceeding 1,000 cc but not exceeding 1,500 cc.

At this level of detail, goods are divided into over 5,000 groups using 6 digit HS codes. HS codes actually range from as few as 2 digits (where they aggregate into 99 product categories) to as many as 10 digits. All countries use 6 digits, but not all countries use the 8 or 10 digit level of specificity.⁶ In tariff negotiations, these are called domestic level headings. The TPP negotiations have been conducted at the level of domestic headings, which will result in considerably more than 5000 tariff lines.

Each of these categories is assigned a particular tariff rate. This is where things get really complicated, particularly with all the overlapping PTAs. For example, the rate on 870322, autos of engines between 1000-1500 ccs, into the United States is generally 2.5%.⁷ However, a host of countries get specific benefits and better terms in their PTAs, including TPP members Australia, Chile, Peru, Mexico, and Singapore. Each is eligible for a 0% ad valorem rate on 870322. This means that these PTA partners can export autos with these engine sizes duty free to the United States and enjoy a margin of preference of 2.5% compared with other, non-PTA parties. Given the cost of a car, a manufacturer that can discount a vehicle by two percent or more compared to competitors in duty savings alone can have a significant cost advantage overall in the marketplace.

The same HS code, 870322, has different tariff rates in other TPP member countries. Singapore, for example, has zero tariffs on all but six total tariff lines (for cigarettes and some alcohol products).

Many countries also have certain tariff peaks. This is where tariffs are generally low, but in a few, specific categories, tariffs can suddenly escalate tremendously. The most famous example of tariff peaks among TPP members is

⁶ GATT/WTO commitments are therefore made at least at the 6 digit level for all members.

⁷ This is the Most Favored Nation (MFN) rate, given to all WTO members and other countries granted Normal Trade Relations by the United States.

⁸ Of 1,323 imported agricultural and livestock products, 101 had tariffs of more than 200 percent. They included: pears (1,085%), peanuts (593%), tapioca flour (583%), adzuki beans (403%), butter (360%), barley (256%), wheat (252%), raw silk (245%), potato starch (234%), raw sugar (232%), and nonfat dry milk (218 percent). Highest of all was the 2010 tariff on konnyaku tubers at 1706%. [Source: Japan's Ministry of Agriculture, Forestry and Fisheries, 2010.]

Japanese polished rice with tariffs of 778 percent, despite an overall agricultural tariff that is much lower.⁸ With a tariff that high, consumers would not buy foreign polished rice: the foreign competitor faces costs nearly 800 percent higher based on duty charges alone.

Tariff peaks can be quite specific—only at the 8 or even 10 digit level does the tariff suddenly escalate. Dairy, for instance, is subject to tariff peaks in many of the TPP countries, especially for specific kinds of dairy products like butter or non-fat dried milk.

Tariff peaks represent particular challenges for negotiators as they highlight sensitive sectors. The fact that these peaks have remained after decades of tariff cutting at the global level through successive rounds of the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO) means that these specific industries or sectors have been successfully protected for some time. Firms in these sensitive sectors are likely to respond vigorously to any attempts to lower tariffs, especially if very high tariffs are cut to zero.

The goal of most PTAs is to get as close to zero tariffs on as many tariff lines as possible. After all, a PTA is a preferential trade agreement, designed to give preferences or benefits to partners that non-partners do not receive. Given the rhetoric of the TPP officials from the very beginning as well as the overlapping nature of the participants, the inspirational objective in the TPP was to create an agreement with no exceptions for goods—100% coverage at zero tariffs once the agreement was fully implemented.

But reaching this goal has proven more difficult in practice than in theory. Officials fairly quickly reached an agreement to drop tariffs to zero on 90 percent of tariff lines on entry into force. The specific disagreements revolved around what ought to happen with the remaining ten percent of goods. Most of these last ten percent of lines also needed to drop to zero, but on a longer time frame (seven years for developed country members and ten years for developing country members). The last one or two percent of goods were particularly problematic—would these items need to drop all the way to zero? If so, under what time frame?

Given the volume of trade between some of the TPP parties, it makes a great deal of difference which products ultimately end up in the first 90 percent and which are placed in the remaining categories. For some members, the bulk of their trade might be found in only a few items. If these tariff lines end up in the last one or two percent with phase-out periods of up to ten years, the benefits of the TPP agreement will look very sparse indeed to businesses on the ground for quite a long time into the future.

IV. Agriculture

Going into the negotiations, it was possible to pinpoint the location of most of the areas of greatest dispute over goods trade. The goods chapter for the TPP is much more comprehensive than most PTA chapters on goods. Many existing agreements either do not cover agricultural products at all or place a large share of items into sensitive product lists without committing to greater liberalization.⁹

Negotiations in the TPP on agriculture were easier than they might have been given the composition of the TPP member countries. Singapore and Brunei are net food importers with no agriculturally sensitive sectors clamoring for protection. The United States already had agreements with Chile and Australia that included agriculture.

The composition of the TPP membership also limited the kinds of products that would cause problems. For example, although market access for soybeans was a major issue in multilateral talks in Geneva as part of the Doha Development Agenda of the WTO, soybeans did not strike such a chord among the current TPP members. Barriers to trade in soy products were largely reduced through bilateral agreements, like the U.S.-Peru PTA.¹⁰

The original TPP members did not raise a fuss over rice, cotton, or corn. These agricultural sectors often include strong sensitivities. Had Mexico or Japan, for example, joined the TPP earlier in the negotiations, these sectors might have been significantly more problematic. However, by the time they entered the talks (in late 2012 for Mexico and mid 2013 for Japan), most of the rules for trade in goods had been sorted out and provisions for market access schedules had also been sketched out, leaving less room for maneuver.

Instead, the two most sensitive TPP agricultural sectors have been sugar and dairy.¹¹ Sugar is sensitive in many countries. The United States, for example, has a long and complex mechanism for supporting sugar production dating

⁹ Every country is protectionist in agriculture to a greater or lesser degree. The lack of coverage of agriculture in PIAs is one of the strongest arguments for handling trade rules in larger, multilateral groupings. Without an ability to trade off concessions in agriculture for sufficiently large benefits in other areas, most states elect to skip agriculture in smaller, bilateral settings or to sign only weak agreements on agriculture. It is only in the WTO, for example, that states are likely to seriously discuss dismantling or reducing trade support for agriculture.

¹⁰ Tariffs on soybeans, soy meal and flour and crude soybean oil were eliminated immediately, with TRQ out of quota tariffs phased out over 10 years.

¹¹ Beef and lamb were also a bit challenging, as the United States, Australia and New Zealand all have strong interests in these markets.

back to the Second World War. These sugar supports have resulted in some of the world's most expensive sugar and one of the most robust lobbying industries in Washington, DC. Sugar has been excluded from all U.S. PTAs.

Sugar products were substantially liberalized under the P4 agreement.¹² In the NAFTA agreement, one of the last items to be liberalized between the parties was sugar after a 14-year wait. Sugar is not just sensitive in the United States, but also in Mexico.¹³

There is also a specific problem for sugar rooted in the complex TPP negotiating environment. This is because sugar was completely carved out of the existing 2005 U.S.-Australia PTA. It was carved out of the agreement at the time as part of a grand bargain that allowed the United States to continue to protect its domestic sugar producers and Australia to opt out of the investor-state dispute mechanism.¹⁴ The former was an important objective for Australia while the latter was a key issue for the Americans. In the end, both sides compromised by excluding these two items from the final agreement.

Now, however, the sugar exclusion presented a new challenge to negotiators in the TPP. If sugar was included in the TPP, it would negate the terms of the AUSFTA. In what was largely perceived as a response to this problem, the United States developed its strategy of refusing to negotiate for new market access with any country with an existing PTA.¹⁵

But excluding sugar from the TPP has been problematic. It has been not just difficult for trade in agriculture. Doing so allowed other countries to argue for excluding their own most sensitive agricultural items. Given the relatively limited economic trade involved between many TPP members, carving out

¹² New Zealand noted that it only agreed to liberalization of sugar products (in solid form, HS 1701) because it did not export such products to Chile. See "Trans-Pacific Strategic Economic Partnership Agreement: National Interest Analysis," New Zealand Ministry of Foreign Affairs and Trade, July 2005, 8.

¹³ The Mexican government, for example, provided over a USD\$1 billion in loans to the domestic sugar industry in the early 2000s through the development bank, Financiera Nacional Azucarera SA. See Gary Clyde Hufbauer and Jeffrey Schott, *NAFTA Revisited: Opportunities and Challenges*, 2005, (Washington: International Institute for Economics), p. 295.

¹⁴ See Ann Capling, *All the Way with the USA: Australia, the US and Free Trade*, University of New South Wales Press, 2004.

¹⁵ This policy was modified slightly with the addition of Canada and Mexico at the negotiating table. The United States announced that it would refuse to negotiate with countries with market access commitments that were "not yet fully implemented." Since the AUSFTA has some tariffs on sugar and out-of-quota dairy commitments that remain until 2022, Australia was deemed to be ineligible for reopening market access commitments. Canadian concessions, however, could still be sought, since the final NAFTA commitments were phased in by 2008.

sectors could seriously erode the potential economic gains from the final agreement. It also flew in the face of a “no exclusions” mantra present from the earliest days of the negotiations.

Finally, carving out a sector like sugar could lead to similar behavior elsewhere in the agreement. Like the AUSFTA example, the exclusion of sugar might result in the carving out of automobiles or investor protections or intellectual property protections for pharmaceutical products. If each of the 12 TPP members were allowed to exclude their “favorite” sensitive product, sector or issue from the final agreement, the result could be a significant step back from the liberalizing goals sought from the beginning.

Dairy has also been a major headache for negotiators. Because the United States does not have a PTA with New Zealand, this sector had never been addressed (unlike, say, the dispute between the United States and Australia over sugar). The primary issue for American milk producers is that New Zealand’s dairy industry is viewed as a monopoly, with one firm (Fonterra) in control of 90 percent of the market and substantial barriers to entry into the market.¹⁶ If the American market is opened to competition through a PTA like the TPP, American dairy farmers feared that New Zealand dairy would receive unfair competitive advantages.¹⁷

As an example, the U.S. Dairy Export Council highlighted deep reservations about the problems of competition in the monopolistic New Zealand dairy industry, which also controlled nearly 1/3 of all global dairy trade (Suber, 2009). In addition to rising problems of direct competition,¹⁸ a TPP agreement that included dairy would undermine some important gains from trade as, for

¹⁶ The WTO’s review of New Zealand (2003) found that dairy was no longer a monopoly, but the company had exclusive licenses to export to some markets from 2010 onwards. Fonterra (USA), Inc. submitted a letter to USTR during the open comment period (through the legal firm of Blank, Rowe, LLP, on March 11, 2009). It argued that the market in New Zealand was open for competition, with no government subsidies, import tariffs or quota restrictions. It also argued that the entire New Zealand dairy industry was smaller than that of California and that it was no more globally competitive than American dairy in various export markets.

¹⁷ Jaime Castaneda estimated that U.S. dairy producers would lose gross revenues of \$20 billion over the first ten years of a PTA. See Testimony, NMPF Producers Federation, March 4, 2009. Land O’Lakes was more careful, but urged USTR to look carefully at New Zealand’s dairy industry for anti-competitive outcomes. See their submission to USTR, March 9, 2009. The National Confectioners Association asked for immediate liberalization of dairy from New Zealand, as it would bring about substantial benefits for their producers, who were forced to manufacture sweets with the highest-priced sugar and dairy in the world. See their USTR submission on March 10, 2009.

¹⁸ This was happening in any case, as New Zealand dairy exports rose from \$454 million in 2004 to \$704 million in 2008. See testimony filed by the U.S. Dairy Export Council, March 10, 2009.

example, New Zealand and Australia would become more competitive in the Peruvian market (where neither state currently had a PTA in place).

These concerns were echoed by the U.S. Dairy Export Council (Suber, 2009). The Council noted its support for nearly all other PTAs, stemming from the experience with NAFTA where Mexico has become the single largest destination for U.S. dairy exports. The American export market used to be driven primarily by the sale of U.S. government stockpiles and subsidized products, but exports had become an important marketplace for domestic producers. Given the export-oriented structure of the dairy industry in New Zealand and the size of the American market, it was likely, the group argued, that much of the production would be directed at the United States.

It is largely due to issues in the dairy market that Canada was not brought into the TPP negotiations sooner. Canada has a long-standing set of practices in place to encourage the growth and development of domestic dairy, poultry and egg farmers.¹⁹ This system was deemed necessary to protect Canadian farmers against competitive pressures from south of the border. The supply management system included setting a floor price and tariff peaks on dairy as high as 300%.

In Canada's existing PTAs, the supply management system for dairy (and poultry) had remained intact.²⁰ In fact, even under a fully implemented NAFTA agreement, Canada continued to have less than free trade in dairy for American and Mexican producers. This has given rise to the potential for substantial changes in Canadian policy going forward that may have an impact on trade levels in dairy with other TPP partners.

V. Textiles and footwear

One of the more challenging areas of TPP negotiations has been textiles and footwear. This is not because all TPP member countries are particularly fussed about these goods. Countries like Australia, Brunei, New Zealand, and

¹⁹ Approximately 13,000 dairy farmers participate in supply management, with the bulk of them located in Quebec and Ontario.

²⁰ Although a somewhat similar system for wheat was dismantled. TPP members were closely following the ongoing talks between Canada and the European Union, under the assumption that supply management was likely on the table in this PTA, which was expected to conclude before the TPP.

Singapore do not produce footwear, nor do they export textiles in any significant amounts. They do import textiles and apparel products.

However, there are three groups of countries that care deeply about textiles. First, textiles and footwear have been historically sensitive in the United States.²¹ In fact, much of the difficulty faced in the TPP negotiations can be traced directly to the complicated system of textile and footwear rules in place to protect the domestic industry in the United States.²² This system of protection includes generally high tariffs, often very high tariff peaks, and extremely complicated rules of origin.

However, the American consumer also represents a powerful magnetic draw for textile and apparel producers, who are willing to jump through these complex hoops to enter the U.S. market.

A second group of countries in the TPP negotiations on textiles have been Vietnam and Malaysia. Neither country has an existing PTA with the United States.

In doing the calculations of benefits from the TPP, Vietnamese officials have pointed largely to the gains from expanded access to the American apparel market, since textile exports accounted for USD\$15.6 billion in 2011 with nearly half destined for the United States (Ngo, 2012). Although Malaysia is not as dependent on textile exports, they nonetheless contributed 2.3 percent to Malaysia's total exports, with 68,000 workers employed in the sector, many working for American apparel brands (Textiles and Apparels Industry, Official Website of the Malaysian Investment Development Authority, 2013). Both Vietnam and Malaysia have been working hard in the TPP negotiations to ensure that they have significantly expanded preferential access to the American market (in particular).

A third group of countries in the TPP are those like Mexico and Peru that already receive preferential access to the American market. Peruvian manufacturers exported nearly 20 percent more t-shirts and other garments in 2012 after new Andean trade preferences came into effect.²³ For countries that

²¹ To a certain extent, Japan fits into the first category as well. Some textiles have been highly sensitive, particularly those associated with the production of kimonos, with very high barriers to entry. However, Japan also produces some types of high-tech fabrics for export and would like to press for expanded access for these products, like the second group of countries.

²² In spite of years of protection, textile (and especially footwear) employment in the United States has continued to decline. The National Council of Textile Organization (NCTO), the largest lobby group for the industry, claimed direct employment of just over 400,000 jobs in 2010. See <http://www.ncto.org/industryemployment/index.asp>, accessed June 24, 2013.

²³ "Peru Economy Expands 5% in 1st Qtr on Textile Exports," *Bloomberg*, May 15, 2013.

already receive preferences, they have been wary of granting newcomers similar benefits. There is particular concern about allowing Vietnam new, easier access to the American market. Vietnam has a highly competitive textile industry that could undercut existing suppliers on price if Vietnamese firms get similar access to the United States. After the removal of quotas from Vietnam in 2007, textile and apparel imports to the United States increased by 60 percent or \$2 billion in two years.²⁴ Prior to any TPP tariff reductions, Vietnamese firms have been paying tariffs in the 12-15 percent range on apparel products and still managing to export billions of dollars of merchandise. If the tariffs vanish, Vietnamese exports should skyrocket as their prices ought to fall in the United States' markets. As a result, this third group of countries has been deeply reluctant to allow Vietnam and Malaysia to have free access to TPP textile, footwear and apparel markets.

Textile market opening has not been discussed among the broader group of TPP members however. Instead, it has largely been conducted on a bilateral basis between the United States and Vietnam (and Malaysia, to a lesser extent). This is because the United States chose not to negotiate collectively with the TPP members, but instead bargain one-on-one with those countries that did not already have an existing PTA (Elms & Lim, *An Overview of the TPP Negotiations*, 2011). For any country with an existing PTA, the market access commitments in the ongoing agreement would simply be transferred wholesale into the TPP.²⁵

Textile negotiations between the United States and Vietnam were extremely slow to get underway in earnest. It was not until 2013 that the

²⁴ The National Council of Textile Organizations (NCTO) argued that it was not a fair competition, as the government of Vietnam had "poured billions of dollars of government support into the sector over the last ten years." Testimony of Cass Johnson, National Council of Textile Organizations, February 24, 2009. In addition, this surge in imports did not merely harm domestic American producers, but also competitors in trade preference areas like Africa, Central America and Mexico. The National Association of Manufacturers urged officials to take careful note of the apparel sector concerns, if Vietnam moved from being an observer to a full participant. Testimony of Franklin Vargo, National Association of Manufacturers, March 4, 2009.

²⁵ This situation changed, however, with the addition of Canada to the TPP in late 2012. The United States altered its stance to argue that it could "reopen" or discuss market access with any country where the existing PTA had already been fully implemented. This would allow new negotiations to take place with Canada and Mexico since the North American Free Trade Agreement (NAFTA) provisions were completely phased in by 2008. However, since the United States was largely not seeking any new market access from Mexico, it remained focused on getting additional access into the Canadian market only.

United States began to seriously engage, after it had worked through a very cumbersome domestic process. In addition, the United States wanted to see what Vietnam was willing to offer elsewhere in the agreement. Vietnam was waiting to see what the United States would provide in terms of market access for textiles before it would commit to potentially painful reforms required by other aspects of the agreement. Sorting out this issue took significant time and intensive discussion about both tariffs and the rules of origin necessary for trade in textiles.

VI. Rules of origin

A preferential agreement is designed to give benefits to members that are not given to non-members. Therefore, one of the key components of a goods agreement is working out the rules that will determine whether or not a particular good is “from” a member and thus eligible for preferences, or not. Note that this can be different from the label stuck on the product that says, “Made in country X.” Trade officials have very specific meanings attached to determining the origin of a good as used by customs officers to decide whether or not a company can get benefits (such as low tariffs or even zero, duty free, tariffs) or not.

In general, there are two types of rules of origin (ROOs). The first is wholly originating. These are products that are 100 percent “from” a particular country—basically items that were grown, harvested, dug up, fished or mined. There is rarely any dispute that these products are eligible for preferences under a PTA.

The second category is much less certain. These are products that must be “substantially transformed” in the member country. By definition, they are not 100 percent “from” a member (otherwise they would be wholly obtained products). So some element is imported from somewhere else. The question is: how much of the final product can be imported from somewhere else? Under the TPP, components that come from other TPP members can “count” towards meeting TPP origin requirements.²⁶

In most PTAs, an origin criterion ranges from 30-45 percent. In other words, a country must contribute between 30-45 percent of the content of any given product, but can import the rest, subject to a host of requirements and

²⁶ This is called “cumulation” and the extent to which cumulation would be allowed was also part of the disputes in the negotiations.

rules.²⁷ One issue in the TPP has been determining the exact amount of domestic content required to satisfy origin criteria. This is tricky, especially as the rule applies to all TPP members equally. It quickly proved impossible to create blanket rules, applicable to all goods products across the board (which would, however, have been higher in quality for the PTA). Instead, officials began drawing up specific ROOs for each tariff line.

Therefore, the ROOs for the TPP are product-specific. A firm exporting chemicals will need to examine the schedules for each and every chemical in the inventory to determine the ROO and method of calculating the ROO before it can claim benefits from the TPP for export into another TPP member country. Note that this chemical company cannot obtain TPP benefits for exports to any non-TPP member countries, even if TPP content is used in making the final product. Only members get benefits.

To really determine the level of market access therefore, it is important to examine not just the tariff levels for any given product, but the ROOs that accompany that product. The case of textiles highlights the interaction between tariffs and ROOs. Textiles have been a particular area of difficulty in the goods negotiations. As noted above, the United States has maintained an extremely complex system of protections for textiles. In order to ensure that American jobs are not lost in textiles and apparel, the U.S. has elaborate rules of origin in place to ensure that most clothing destined for the United States using PTA preferences is manufactured with American-made fabric and yarns. Basically, if a firm wants to take advantage of a PTA, it must ensure that all components of a product are manufactured from the yarn all the way to the end product under the so-called “yarn forward” rules of origin.

Yarn forward has been used in all U.S. PTAs. However, it is not 21st century or particularly high quality. So officials faced a dilemma in negotiating in the TPP from the very beginning—how to reconcile the existing PTAs on textiles with the ambitious goals for the TPP? After nearly three years of talks, the U.S. officials began moving ahead in 2013 with a scheme designed to reconcile these conflicting demands. The U.S. Office of the Trade Representative (USTR) began to draw up a list of items in “short supply.” These were textile products that could not be manufactured in TPP member countries in sufficient quantities to satisfy demand.

²⁷ For example, a firm may not simply relabel a product, or repackage a product. It cannot do simple assembly like combining two items together with a screw, but generally must “substantially transform” the two items in some meaningful way to create a new product. The specific criteria required to satisfy the “substantial transformation” requirement has been painstakingly negotiated by officials in the TPP; again, largely at the tariff line level of detail.

The short supply lists had two categories—permanent lists for products that would likely never be sufficiently available (like silk) and temporary lists (subject to three years of relaxed rules of origin).

The fight in the negotiations then moved to whether or not the items on the short supply lists could, in fact, be manufactured in TPP member countries. If not, TPP members would be free to source fabric from anywhere and use an alternate rule of origin called “cut and sew” to prove origin for their final products, at least for the temporary period.

This provoked concerns among many of the groups worried about new market access into the American market. U.S. textile manufacturers immediately began howling that such a rule would destroy the last remnants of their industry. Those countries that already get benefits like Mexico and Peru began lobbying hard to preserve their unique access. Even non-TPP members got into the act. Many of the countries of the Caribbean, for example, began to petition trade officials and members of Congress to explain that if the proposed short supply lists went into effect, they would lose their privileges under the Central American Dominican Republic Free Trade Agreement (CAFTA-DR).²⁸

Again, it is necessary to view the tariff cuts in tandem with ROOs to determine final levels of market access for the agreement. It is possible to cut tariffs for textiles to zero, but if the ROOs remain yarn-forward, many firms will struggle to take advantage of these provisions. Even once they have changed their sourcing patterns to buy only TPP-made fabric in the future, they may not reap the cost benefits that they currently enjoy if TPP-made fabric is significantly more expensive than non-TPP fabric. On the other side, if the ROOs are changed to allow “cut and sew” rules, many firms in Vietnam and elsewhere believe they will be quite profitable even if the tariffs remain higher than zero.

VII. Tariff rate quotas and unresolved alignment issues

Another deeply challenging issue for TPP has been the tariff rate quota (TRQ) system. Because agriculture has historically been so sensitive, repeated rounds of

²⁸ Technically speaking, they would not lose their privileges under CAFTA-DR. But apparel companies like the Gap or Hanes would increasingly locate production in Vietnam over smaller Caribbean countries with higher costs if the tariff savings for Vietnamese suppliers were sufficiently large. The net result, from the perspective of many Latin American countries, however, would be a loss of American market share and export-related textile jobs.

negotiations in the GATT largely left agricultural products uncovered. In the Uruguay Round talks, officials decided to include agriculture for the first time.

Up until this point, states had protected agriculture by a combination of high tariffs and non-tariff barriers, especially in the form of quotas. In order to properly address these barriers, officials created a system to translate non-tariff barriers into tariff terms. Over time, officials expected that barriers to trade in agricultural products would fall, just as other tariff barriers to trade have fallen in repeated rounds of negotiations.

Under the TRQ system, products were generally assigned two tariff rates and a specified quantity of imports allowed. The first, lower, tariff rate would apply for all imports of products up the quota. A second rate (frequently much higher) would apply for all imports above the quota.²⁹ The Uruguay Round Agreement on Agriculture (AOA) established over 1,425 TRQs, mostly used by developed economies. TRQs can be set up as “supplier tariff quotas,” or are country-specific rather than being open for imports from all WTO member states.³⁰

TRQs have followed in PTA negotiations. For example, under the U.S.-Peru agreement, the United States provided Peru with a 9,000 ton sugar TRQ and an additional 2,000 ton TRQ for specialty sugar.³¹ This allows Peruvian exporters to ship up to 9,000 tons of sugar per year to the United States, provided that Peru is a net exporter of sugar and that the United States does not choose to invoke its right to provide compensation in lieu of accepting imports.³² The 9,001st ton of sugar exported by Peru is subject to significantly higher tariff rates.

TRQs are only allowed for agricultural products. But they have complicated life for TPP negotiators as TRQs exist in both the WTO and in many of the bilateral PTAs. If Peru has already been granted a TRQ of 9,000 tons on sugar in the bilateral agreement, what will happen to this quota under

²⁹ If the second, out-of-quota tariff was set high enough, the entire formula effectively reduces to an import quota.

³⁰ This allows discrimination to take place within the WTO. Note that TRQs have been the subject of many disagreements and disputes in the WTO system, particularly about the methods of determining country specific quotas and the non-transparent administration of some country's systems.

³¹ The former quota also expands at two percent simple annual growth per year, while the latter does not expand over time with growth. See “U.S.-Peru Trade Promotion Agreement Fact Sheet,” U.S. Department of Agriculture, September 2009.

³² The exceptions to the TRQ shown in this example highlights both the complexity of the TRQ administration as well as some of the mechanisms that can be used to prevent imports.

the TPP? Officials wrestled with this problem for three years without resolving it in the negotiations.

Another unresolved issue stemming from the overlapping PTAs is how to bring all the American market access schedules into alignment. As noted earlier, the U.S. chose to negotiate bilaterally with non-PTA parties. The market access commitments for any country with an existing, not-yet-fully-implemented schedule stood as the American offer for the TPP. Given that most of the PTAs bring tariff lines to zero and the TPP objective is to reach zero tariffs as well across the board, as long as the existing PTAs go to zero there is no compatibility problem between the agreements.

However, not all existing PTAs go to zero. Some have longer implementation schedules than the TPP. And some, notably the sugar exclusion from the Australian agreement, are plainly incompatible with TPP market access objectives. Still unresolved in mid 2013 is how to bring all these agreements into alignment with the TPP commitments by the end of the implementation period for the TPP.

VIII. Japanese participation

In July 2013, the TPP expanded again to include twelve countries with the formal addition of Japan. Part of the entry conditions included a provision that Japan could have extra time to wrap up its own market access commitments with the TPP parties, if the agreement closes before Japan has a chance to conclude its schedules. Japan's market access discussions are likely to be fraught on the goods side. The most obvious impediment to joining the TPP overall has been the historically high levels of protection offered to Japanese farmers. The political structure is tilted to provide heavier representation of rural areas. Although farming does not contribute much to Japan's overall GDP, the 2.5 million Japanese who farm full or part-time are a formidable force, operating through the Japan Agriculture (JA) Group (Takada & Yuriy, 2012). As part of its entry statement with the United States, Japan's Prime Minister Abe pledged to take special care of six sectors including rice, dairy, sugar, wheat, beef and pork (Yoshida, 2013).

Within the TPP, officials have been strongly divided about the wisdom of including Japan in the group. Nearly all have recognized the economic importance of adding Japan to the TPP. This is particularly true as the current 11 partners are well connected through existing PTAs. But Japan is not as

linked to the rest on a bilateral or regional basis outside of the TPP.³³ Nor are the existing agreements with Japan as comprehensive or deep as the TPP. For example, most Japanese PTAs carve out or exclude significant portions of agricultural trade. Also, one important objective of the TPP is to facilitate trade in value chains. Including Japanese firms in an Asia-Pacific regional agreement provides a significant boost to achieving this objective.

However, offsetting the benefits of getting Japan in have been the challenges of including Japan—especially at such a late date in the negotiations. There has been a real concern across many countries that Japan will stall, unpick or destroy the deal on the table at such a late date in the talks. Some of these actions could be deliberate, but some could be inadvertent. The mere fact of Japan’s entry, as noted below, could upset the balance on various outstanding issues.

Knowing that Japan will be present sped up and slowed down the bargains on the table for most of the first half of 2013. Part of the agreement for entry included the provision (also applicable for Canada and Mexico) that existing “closed” chapters cannot be reopened.³⁴ This provided a strong incentive for the TPP 11 to close out as many chapters as possible prior to Japan’s entry. However, this came with a catch—for any country with a specific position remaining that believed that Japan might be helpful to their concerns and position, they had the opposite incentive—to prolong negotiations until Japanese officials could lend their weight to one side of an argument.

IX. Conclusions

The TPP has been touted from the beginning as a “21st century, high quality” agreement. It could be setting the standards for trade agreements going forward. The continued expansion of membership from four small countries to

³³ Japan is connected to the ASEAN member states of Brunei, Malaysia, Singapore and Vietnam through the Japan-ASEAN agreement, but it covers goods trade only. Services and investment negotiations have been proceeding at a snail’s pace. Brunei, Malaysia and Singapore also have bilateral agreements with Japan, as does Mexico and Peru.

³⁴ It appears that Japan was also granted additional time to complete its own commitments and schedules, if necessary. Canada and Mexico were given up to six months beyond the completion of the TPP to conclude (especially) their market access commitments for goods and services. Japan was apparently given up to 12 months.

twelve suggests that governments view the TPP as a desirable regime for trade liberalization and rule making.

The agreement as a whole contains many new elements and an expansion in depth and scope of existing provisions from other PTAs. On the goods side, however, the TPP will likely not be seen as game changing. It does not break new ground in creating new trade rules. Depending on the benchmark, it may not provide substantial liberalization beyond other PTAs.³⁵ The rules of origin (ROOs) are complex and cumbersome. The level of substantial transformation required for most products is relatively high for an agreement with sweeping claims of novelty. It is likely that quantitative restrictions in the form of TRQs for some agricultural products will still exist in the TPP. And the addition of Japan, which has highly protected markets (especially for some agricultural products), makes it less likely that the target goal of 100% coverage at zero percent tariffs will actually be met.

X. References

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³⁵ This is tricky, as for some countries and in some PTAs, the TPP does represent substantial improvement over existing agreements. Assuming it provides at or near 100% coverage and at or near zero tariffs, this is a strong improvement over many ASEAN agreements that allow substantial carve outs of sensitive sectors or overly long implementation periods. But for other countries or agreements that routinely drop tariffs to zero on nearly all products, the TPP does not represent a dramatic shift.

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