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AUSTRALIA AND THE FUTURE OF THE TRANS-PACIFIC PARTNERSHIP AGREEMENT

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Australia and the future of the Trans-Pacific Partnership Agreement

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Abstract

The Trans-Pacific Partnership (TPP) Agreement aims to be a high quality, 21st Century economic agreement that furthers economic integration in the Asia Pacific. In late 2011 it remains unclear whether the TPP will turn out to be a stepping stone or stumbling block towards regional or global economic integration. The current negotiations involve Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam with Japan, Mexico and Canada expressing interest in joining. The potential economic and political significance of the TPP depends on the expansion of the membership to include Japan, Korea, Indonesia, other East Asian economies, and especially China, as well as the ultimate quality of any agreement. Including additional members will be difficult after a deal is concluded among the original members and partners with whom they are currently in negotiation, especially if the content of the agreement and the accession criteria are not designed carefully and specifically with additional membership in mind. Desirably TPP will contribute to the global system by making it easier for others to join. That includes multilateralising preferences within the TPP, and eventually extending that treatment to non-members. Importantly, the agenda of negotiations needs to focus on reducing regulatory and institutional, behind-the-border barriers to trade and commerce. Focus on strengthening intellectual property rights, including stringent labour and environmental and other so called "platinum" standards will make it difficult for many members and non-members to participate fully. The TPP has the potential to keep the United States engaged in the region but complications will arise with a TPP to which China is not party, or an inward looking East Asian arrangement to which the United States is not party. A regional arrangement that does not include both the United States and China is more likely to disrupt than to contribute to regional trade and prosperity.

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Background

The Trans-Pacific Partnership (TPP) Agreement aims to be a high quality, 21st Century economic agreement among the nine members who have so far signed on to negotiate it: Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam. It grew out of the P4 (Brunei, Chile, Peru and Singapore) which are all small, open economies. When the United States decided to join the **negotiations** in September 2008, the TPP was at once elevated to a bigger agreement and required difficult decisions from other Asia Pacific economies as to whether they should join. The political context is that it is seen as the Obama administration's main trade policy initiative and the main pillar of US economic engagement in the Asian region.

Following the US announcement that it would join the TPP negotiations, Australia announced it would join negotiations in November 2008. Around the 2011 Honolulu APEC meeting, Japan, Mexico and Canada expressed an interest in joining negotiations but are yet to formally apply or be admitted.

The economic rationale for the TPP is to connect existing and overlapping agreements in the region and further economic integration towards a Free Trade Agreement of Asia and the Pacific (FTAAP)¹. The political and strategic rationale is more complicated but, at its heart, is the idea of keeping the United States engaged in Asia.

The United States has free trade agreements (FTAs)² with Australia, Chile, Peru and Singapore, and there are many other FTAs among the nine potential members. Only 11 of the 36 bilateral relationships among TPP members are not already covered by FTAs. The TPP has also been promoted as a way forward for the long term vision of a potential FTAAP. FTAs can create trade among members but can also divert trade from non-members to members. They complicate the pattern of, and cost of, trade with overlapping rules of origin when different preferential tariffs are applied at the border depending on the origin of each part or component of goods. The TPP is, in one conception, an attempt to deal with these bilateral FTAs by trying to join them up.

The TPP is seen by some as an attractive way forward towards a binding regional trade or economic agreement because it can build momentum by joining up like-minded members from anywhere in the Asia Pacific region. If membership did expand, and the TPP market became larger, there would be more incentive to join in order to gain better access to that market. The starting point is with small open economies (P4 members), those with existing FTAs, or like-minded countries (such as those with political alliances).

Progress on binding regional trade agreements has been difficult through APEC because of the diversity of membership and non-binding nature of cooperation in APEC.³ The failure of the Doha Round in the World Trade Organisation (WTO) has added impetus to the TPP negotiations.

¹ The merits of an FTAAP are open to debate but that debate is beyond the scope of this paper.

² This paper uses FTAs to cover preferential trade agreements (PTAs), economic partnership agreements (EPAs) and any other bilateral or regional trade agreement that has preferential tariff and other features.

³ For a clear statement of the guiding principles of APEC, see the Seoul APEC declaration from 1991 at <http://www.asean.org/1041.htm>

But can the TPP contribute to broader regional economic integration? And without the regional economic integration driven by TPP coming at the expense of global economic integration? The current members comprise a small portion of regional trade but it is the potential of having other members join that makes the TPP really significant. Given the complexities in negotiating a high quality deal often takes many years, now is a key time at which to ensure the agreement is designed in a way that contributes to regional economic integration, rather than detracts from it. This paper considers some of the potential outcomes and highlights the conditions that are needed in the design of the TPP for accession by new members, its contents and features that could make it a regional agreement that promoted regional integration at the same time as contributing to the global trading system.

This paper is organised as follows. The next section discusses the Australian circumstance in opting to join the TPP. Then the regional economic integration context is reviewed with a focus on the origins of the gains thus far and recent developments in regional FTA strategies. The paper then examines the largest economies in the Asia Pacific, their potential roles in the TPP and how they will ultimately determine the significance and success of TPP. First, the US's role in the TPP is analysed given the strategic significance of its involvement. That is followed by examination of the situation of some other key economies in East Asia which have unique and pivotal roles in the Asian integration process. The paper then looks at China and discusses whether China should join the TPP. Some principles and ways forward that flow from the rest of the paper are set out, before concluding.

Australia and the TPP

Australia's decision to join the TPP negotiations and to host the first round of the negotiations in March 2010 was made in the context of a stalled Doha Round at the WTO, the proliferation of FTAs in the region and globally and Australia's already having a bilateral FTA with the United States. Australia also has FTAs with three of the four P4 members of the TPP: Chile, Singapore, New Zealand. The Australia-Singapore relationship could eventually be covered under three trade agreements with TPP, ASEAN-Australia-New Zealand FTA (AANZFTA) and the Australia-Singapore FTA.

Australia sees the TPP as an important way to keep the United States engaged in the East Asian region (Crean, 2010)⁴. Some in Australia also felt that the TPP was an opportunity to obtain greater access to US markets than was achieved under the Australia-US FTA (AUSFTA) and to lock in the established relationship with United States (Ranland, 2010).

In 2010, 67 per cent of Australia's total trade was with East Asia, including 77 per cent of Australian exports going to the region. That share has been growing over time as Australia has become more reliant on East Asian markets and shifted its trade away from the United States and, in an earlier time, Britain. Australia's share of trade with East Asia is second only to that of Indonesia, at 69 per cent, although the share of Indonesia's exports going to the region is lower. It is in Australia's interest to keep regional trade open and not lock in relationships preferentially at the expense of others

⁴ The United States is also a member of APEC and the East Asia Summit (EAS). TPP and the EAS membership are new initiatives for the United States but the EAS is not yet a robust economic forum.

as that would fragment Australia's trading relationships and involves picking preferential trading partners. Australia's two largest trading partners are China and Japan which are currently not members of the TPP negotiation, and in 2010 they accounted for 36 per cent of Australia's total trade and 44 per cent of Australia's exports.

Previously a champion of non-discriminatory, unilateral liberalisation and open regionalism, Australia concluded its first FTA, after the Closer Economic Relations agreement with New Zealand, with Singapore in 2003.

The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or the CER Agreement) has been in force since 1983 but the overall trend of Australian trade policy over the ensuing years was multilateral in orientation and the agreement with New Zealand was negotiated in the context of both countries' commitment to multilateral liberalisation. That agreement is perhaps the only preferential trade agreements which covers all trade in goods as well as all services other than a very short negative list, and includes the free flow of labour.

A more significant shift in Australian trade policy strategy really occurred with the negotiation of the Australia-US Free Trade Agreement (AUSFTA) which came into force in 2005. The Singapore FTA did not include agriculture and was not of the same scale or importance economically or politically as was AUSFTA. The AUSFTA did cover agriculture, but the only significant new access to United States agriculture markets was for lamb, largely at the expense of New Zealand.⁵

Since then Australia has signed FTAs with Thailand (2005), Chile (2009) and with ASEAN and New Zealand (2010) and has FTAs under negotiation with China, Japan, Korea, Malaysia, India and Indonesia. Australia is also negotiating the Pacific Agreement on Closer Economic Relations (PACER) Plus with its Pacific Island neighbours and the Gulf Cooperation Council (GCC), comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates⁶. The most important of these negotiations are with Japan (started in 2007) and China (started in 2005) but both sets of negotiations are ongoing or effectively stalled.

In key political relationships, once political commitment has been made to negotiate and conclude an FTA, there is significant incentive to complete a deal no matter the quality, in order to save face geopolitically. There is also domestic pressure to conclude agreements with large trading partners or allies. A retreat from either the Australia-Japan or Australia-China FTAs without having something else supersede them would likely hurt bilateral relations politically. The major sticking point in the Australia-Japan FTA is agriculture in Japan. The TPP is one way more external pressure might be put on Japan to liberalise agriculture (for its own economic benefit) than in the bilateral Australia-Japan FTA negotiation, given that Doha is dead, and appears to be an attractive feature of the TPP way for Australia out of its impasse on the bilateral FTA.

Australia's FTA initiatives have always been prosecuted under the rhetoric of the priority attaching to the multilateral trade system and the FTAs have been labelled

⁵ Dairy and sugar products were excluded and there was no meaningful assured additional access for beef. In late 2011, the United States is seeking to exclude beef, dairy and sugar from a potential TPP.

⁶ Source: Australian Department of Foreign Affairs and Trade: <http://www.dfat.gov.au/fta/index.html>

WTO-plus or at least WTO-consistent despite FTAs being in direct contradiction of the core WTO most favoured nation (MFN) principle.

Yet Australian trade policy strategy is currently being re-thought and there is movement back towards a more non-discriminatory stance. The Australian government commissioned report on *Bilateral and Regional Trade Agreements* by the Productivity Commission in 2010⁷ concluded that, thus far, the economic gains from Australia's FTAs have been "modest" and given the lack of strong economic or trade benefits, are probably best described as political, rather than economic agreements. Assessment of the TPP was not included in the report, given that ex-post analyses could not include a future agreement and that CGE-type models cannot analyse its impact given that the specifics of the Agreement were still unclear. The report recommended analysis of the impact of all future such trade agreements, prior to their being proceeded with. The report also explained that CGE models were not adequate to analyse the effects of preferential trade agreements, warning that modeling based on optimistic assumptions about the coverage, extent and certainty of liberalisation were misleading.

The conclusion is that none of the discriminatory or preferential FTAs that Australia has signed to date has led to significant economic benefits. Australia's FTA with the United States, the AUSFTA, excluded sugar and other sensitive sectors, as most FTAs do. If Australia and the United States, who are political allies, could not liberalise sensitive sectors in an agreement with strong political backing, it is likely to be very difficult to do so in a similar arrangement among a larger group of more diverse partners. There was early evidence from the USTR before formal TPP negotiations got underway that sugar would not be put on the negotiating table (Strawbridge, 2010; Elms, 2011).

The assumption or belief in trade negotiations that gaining market access in foreign markets is the main goal is not consistent with the evidence that the largest economic gains accrue from what is liberalised domestically.

Australia's Trade Minister, Craig Emerson, adopted many of the recommendations of the Productivity Commission's report including a recommendation that changes to the Australian pharmaceutical benefits scheme will not be negotiated in trade agreements, intellectual property rights (IPR) will not be strengthened through trade agreements and investor-state dispute settlement will not be included in trade agreements⁸. These are three of the United States' major demands in the TPP negotiations (Ranald, 2011). The Minister did not accept the recommendation that all agreements proposed should be subject to Productivity Commission analysis before implementation.

In this context, as set out in the Productivity Commission Report showing that the economic benefits of FTAs are marginal and that the agreements are more political than economic in nature, despite good intentions, Australia may yet enter an economically weak TPP for strategic and political reasons rather than economic reasons.

⁷ The Productivity Commission's report can be accessed at <http://www.pc.gov.au/projects/study/trade-agreements/report>

⁸ 'Gillard Government trade policy statement: trading our way to more jobs and prosperity', Canberra, 12 April <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf>

Asia Pacific economic integration

The larger the FTA grouping, the larger the potential gains but there is ample evidence that gains from multilateral, non-preferential trade are larger than gains from even region-wide FTAs (Dee, 2007). Even larger gains accrue from unilateral liberalisations, importantly through domestic regulatory reform (Dee, 2007).

East Asian economic integration has been market driven, not institution driven and production networks have prospered despite FTAs which complicate the sourcing of intermediate imported inputs because of the rules of origin issue. The Asia Pacific region, and especially East Asia, has enjoyed rapid growth of trade and development based on the idea of open regionalism (Garnaut, 1996). The region's interests have aligned closely with a global framework predicated on keeping markets open and having a robust, non-discriminatory global trading system. Underpinned by confidence in the global trading system, and institutions such as APEC, many economies in the region undertook much trade liberalisation unilaterally, without binding agreements (Elek and Soesastro, 2009). This was the only way forward for a region as diverse as the Asia Pacific as countries at different stages of development and reform, and with different economic and political systems, could not readily sign on to binding agreements with uniform provisions (Elek, 2010).

East Asia's domestic commitments to openness and unilateral trade and investment liberalisation, together with advances in transport and communications technology, subsequently led to a complex set of production networks with deep specialisation often at each stage of production for manufactures. These supply chains are led by electronics and automobiles (Ando and Kimura, 2005) but extend across manufacturing in many sectors. In 2006, roughly 40 per cent of manufacturing trade in East Asia was parts and components trade with half of all trade in machinery and transport equipment (SITC 7), and almost two-thirds of information communications technology goods trade in parts and components (Athukorala and Menon, 2010). Yet the East Asian production networks and the regional integration is dependent on external markets as the destination for final goods and this structure of regional trade continues to recommend maintaining an open global system and avoiding an inward looking, preferential set of arrangements that further fragment regional trade from the global system.

Given the deep integration that has occurred in East Asia around these production networks, there is evidence that East Asia is at least as economically integrated as the EU in trade terms without the need for preferential trade or a customs union (Armstrong and Drysdale, 2011).

Most border barriers to trade have already been substantially reduced but there are some important residual barriers to trade which are concentrated in developing countries and in politically sensitive sectors in most economies. The largest gains and the priority is now in regulatory and institutional behind-the-border barriers to open markets and these barriers are rarely susceptible to change in a negotiating framework (Elek, 1995).

One priority in furthering East Asian economic integration is to promote the participation of least developed economies in the production networks as well as

deepen the integration and specialisation of middle-income economies in those supply chains. This is an integration agenda beyond a narrow trade agenda.

Tariffs and other trade barriers in the region are already on average low, but there are some significant gains to come from liberalising the sensitive sectors such as agriculture. In addition, there is focus on liberalisation of service sectors to foreign competition and liberalisation of investment. The sensitive sectors often left out of FTAs, such as agriculture or liberalisation of utilities sectors in services trade and investment, require domestic reform in concert with liberalisation. Agricultural reform, such as the elimination of US subsidies, is a deeply domestic issue. There has been very little, if any, success in reducing these impediments significantly through the negotiation of bilateral trade agreements. Services and investment are areas in which there are potentially large gains from liberalisation but the gains accrue from opening up competition to domestic firms, not only to foreign firms, and are therefore not suited to trading concessions in an international negotiating framework (Dee and Findlay, 2009). This can be viewed as own market access, beyond national treatment. Indeed, there appears to be zero evidence of services chapters in FTAs having any impact at all except in Europe (Francois and Hoekman, 2010).

The experience in Australia shows investment provisions in trade agreements bind current arrangements and provide protection against future policy changes rather than reduce existing investment barriers (Productivity Commission, 2010).

FTAs, or trade liberalization through international negotiation, lack one of the key mechanisms for helping to solve the problem of sensitive sectors — that is, a mechanism for giving voice to the domestic interests who are hurt by import substitution. Any mechanism that levers off "offensive" and "defensive" interests will fail to do this (including the WTO process). Such a domestic mechanism was important for unilateral reform in Australia in the 1980s that opened up sensitive sectors to international trade and competition (Findlay, et al. 2003).

It is the pluralistic and globally oriented arrangements in Asia that have facilitated their deep integration into the regional and global economies. Asia Pacific integration has not been the product of preferential-style regional trade arrangements at all. The region has not thus far succeeded in negotiating any large-scale binding agreements among multiple members outside of ASEAN, such as the FTAAP, EAFTA or CEPEA because of the diversity of the region and the difficulty of locking in, or binding, countries at vastly different growth rates, stages of development, with different economic and political systems. That experience recommends care in designing and negotiating any binding agreement for the region.

Many of the aims of the TPP are important to deepening regional integration such as "addressing behind the border issues like reducing customs paperwork; promoting regulatory coherence, including through encouraging cooperation between regulatory bodies; focussing on transparency in terms of regulation and administrative processes" (DFAT, 2010). The question is whether preferential agreements are the best way to deliver these domestic regulatory reforms (Findlay, 2010). And there is the question of whether the other items on the TPP agenda pose real risks to the region both economically and politically (Elek, 2010).

A priority at this moment in global economic history is connecting regional initiatives to global outcomes, and to have both reinforce one-another (Drysdale and Armstrong, 2010). Any regional arrangement, especially if it involves one or more of the biggest world players, needs to be designed to contribute to strengthening the global trade and investment environment, not detract or delink from, and thereby weaken, it.

What can the TPP deliver given that services trade liberalisation can only be driven domestically and the EU is the only example of international negotiations in services trade liberalisation succeeding? Much of what is being negotiated in the TPP has failed in other forums which are less confrontational and more flexible in nature than what the TPP appears to be (for example in APEC) and that should factor in when shaping the TPP agreement. There is a risk that there will be a disconnect between the TPP agenda and other regional initiatives. The APEC processes of working on trade facilitation, common objectives, individual action plans towards those common objectives, and peer review for mutual support, will not be helped if the TPP ends up being an exclusionary preferential agreement. The paper takes up these questions below.

The United States and the TPP agenda

With the Korea-US FTA (KORUS) passed through the US Congress, and with the Doha Round of negotiations in the WTO having collapsed, the TPP is the single most important trade initiative on the United States agenda (Barfield, 2011). It is seen by many in the United States as the tool with which to lock in important Asian economic and political relationships and as a way to avoid being excluded in the East Asian economic integration process (Gao, 2010; Bergstrand and Schott, 2010; Barfield, 2011). Bergstrand and Schott (2010) argue the TPP is necessary to avoid a line being drawn down the Pacific with the United States left out of a China-led and China-dominated East Asian process.

Completion of deals such as the China-ASEAN FTA and the strengthening of the ASEAN+3 and ASEAN +6 processes caused worry in the United States over whether Asian integration was moving forward without US involvement. One response is the United States' joining the East Asia Summit and the other is joining TPP negotiations.

US trade with TPP countries represents 5.3 per cent of total US trade (Drysdale, 2011). That would increase to 11 per cent if Japan joined. In terms of the share of global trade, as it currently stands the TPP represents a very modest deal in global trade liberalisation as well as US trade but is an arrangement that is important for its potential (Barfield and Levy, 2009). The aim is to put pressure on non-members to join through a kind of domino effect—both a political (Ravenhill, 2010) and economic domino effect (Baldwin, 1993).

The structure of US FTAs is for mandatory inclusion of stringent labour and environmental standards, with pressures from US industry groups leading to changes in pharmaceutical, local media content and other regulations in the partner country, and much stronger IPR enforcement (Ranald, 2011).

The standards that the United States is demanding in the TPP are more stringent than standards in the WTO (Barfield, 2011) and the aim is to have those "platinum" standards, not gold, as its current FTAs mostly are said to be. US FTAs have followed the

NAFTA template that supports US-style legal frameworks promoting the legal rights of corporations at the expense of the rights of governments to regulate corporate activity, especially in IPR (Ranald, 2011). James (2010) explains USTR Kirk's statement that because the agreement can be started from scratch, the US Congress is more open and receptive to the TPP idea since it will be able to insert potentially deal-breaking labour and environmental standards. The deal is in fact starting from the P4 template but the P4 did not cover financial services or investment (Hamanaka, 2010) and the negotiations in 2010 essentially started from scratch. The TPP may be shaped by powerful constituents and act to protect certain interests via Congress, rather than an take an economy-wide view which might be favoured by the Administration (James, 2010).

Ambassador Kirk's letter notifying Congress of the Administration's ambitions for the TPP included the aim of enhancing the "agreement's focus on environmental protection and conservation, transparency, workers' rights and protections" (Kirk, 2009). Kirk's letter has been interpreted as requiring more reforms by the existing US FTA partners that would "upgrade" them to incorporate new US "platinum" standards on labour, environment and intellectual property (Bergsten and Schott, 2010; Ranald, 2011).

IPR protection standards would make it difficult not just for developing countries but also developed countries that are potential members of the TPP to join on. The AUSFTA experience saw copyright of US content being extended in scope and length in Australia. The IPR chapter (Chapter 17) was the longest chapter in the AUSFTA. As a net exporter of copyright material, there is strong incentive to secure and increase the copyright rents for US business but in terms of global welfare another balance might be preferable. The IPR protection that the United States is pushing for in the TPP negotiations has already created controversy⁹.

New Zealand is negotiating for IPR protection no stronger than the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Australia is resisting even stronger protection than the TRIPS-plus or WTO-minus provisions in AUSFTA (Faunce and Townsend, 2011). IPR that is too restrictive impedes innovation (not encourages it) and impedes equitable access, for example, to generic medicines (Faunce and Townsend, 2011). Such measures could be even more costly for developing countries.

Perhaps the biggest issue is that the TPP is in many respects fundamentally a political and a security tool (Barfield, 2011) to strengthen US ties with allies in the region (Barfield and Levy, 2009; Bergsten and Schott, 2010). The US approach towards TPP has even been interpreted as a divide-and-rule strategy of the United States towards Asian regionalism (Hamanaka, 2010). Yet the current strategy of trying to create a domino effect of countries wanting to join the TPP is more promising than doing that by continuing to sign bilateral agreements with individual Asian countries. Given the difficulty experienced in passing KORUS, the TPP may appear a more attractive strategy from the United States' perspective than individual bilateral agreements.

As Barfield (2011) warns, the United States, pushed by powerful lobby groups, should not overreach in its demands but keep in mind the strategic focus on its long-term goal

⁹ There have been numerous leaks of the US proposed IPR chapter. See, for example, <http://keionline.org/node/1091>

of an FTAAP or trans-Pacific architecture. That includes political and security structures, as well as economic arrangements, and pushing on narrow interests in negotiations with the risk of making it difficult for China to join, or for Vietnam to fully participate, would not be consistent with that strategy.

Non-participants

Japan

Japan's eventual participation is important for, and would elevate the potential significance of, the TPP. Japanese leadership announced before the APEC summit in Honolulu in November 2011 that Japan intends to start a process aimed at joining TPP negotiations.

The debate in Japan about whether it should join the TPP negotiations crystallises the domestic and foreign policy challenges that Japan has to come to terms with. On the domestic front, the TPP is cast in terms reforming the protected agricultural sector and modernisation of the economy. Internationally, the dilemma in commitment to the TPP is symbolic of the bind of Japan's position between its ally, the United States, and its largest economic partner, China.

The heavily protected and inefficient agricultural sector in Japan is a drag on the economy. If Japan's membership of the TPP can be deployed as the tool to break this long standing impasse, as many see it, it would have significant implications for Japan's foreign policy and foreign economic diplomacy. The inability to open up the agricultural sector has hamstrung Japan's involvement in other FTAs, most prominently the Australia-Japan FTA, and other initiatives Japan wants to take regionally and internationally.

KORUS was a significant impetus for Japan to push for TPP membership as under KORUS, Korea will have preferential access to the market US.

The strategy that Japan is taking in its approach to TPP membership recognises the possibility that China will not join the TPP any time soon. Given the importance of China to Japan, both economically and strategically, Japan is signalling moving forward on a bilateral FTA with China at the same time as its signals intent to join the TPP negotiations. Japan is in fact pushing forward with FTAs with China, Korea and the EU at the same time as moving towards joining TPP negotiations (Ennis, 2011).

Indonesia, Japan, Korea and China have large and complex economies with strong interest groups. The willingness for them to join TPP is likely to be significantly reduced if the negotiations are completed prior to their joining. It will be close to impossible for them to negotiate revision of terms and conditions of the agreement once negotiated and passed through US Congress.

In practice, there would be strong incentives to close off accession until there is an agreement among the foundation members and then to negotiate one by one with new members rather than incorporate open sign-on based on meeting certain standards and criteria (Findlay, 2010). There may be some who think joining the "club" and gaining US market access will dominate these negative considerations but the difficulties would be

significant for Indonesia, Japan and Korea (Barfield, 2011). The difficulties for China to join would be even greater.

China

The ultimate strategic challenge for the TPP relates to China's membership (Drake-Brockman, et al. 2011).

The biggest risk of the TPP is the political risk that it will divide the region strategically between its members and the rest, with China, for example, not being a member. The TPP has been supported by Bergsten and Schott (2010) as a way for the United States to engage in East Asia as "China propelled the advance of Asian regionalism" and "these countries are well on the way toward creating an Asian bloc, a development that could "draw a line down the Pacific" by discriminating against [the US]". Yet if the TPP proceeds on terms set by the United States, it would be very difficult for China to join (Drysdale, 2011), it may not be in China's interests to join and may in fact "drive the region apart with systematic exclusion of non-members, including China" (Findlay, 2010). This wedge through the middle of the Pacific will be political as well as economic (Drysdale, 2011). Bergsten and Schott (2010) are among the TPP's biggest and most vocal US proponents and give priority to Japanese and Korean membership, envisioning the use of those strengthened alliance relationships to balance the influence of China. China would have to join the TPP on US terms as the TPP will be done mostly on US terms.

The difficulty for China to join stems from aiming now for an agreement designed by, and for, countries with established strong IPR, labour and environment standards typical of a developed country, not to mention other commercial settings. Many will be watching the conditions which are defined for Vietnam, the least developed country in the potential TPP. If the standards are appropriate for Vietnam, the key then will be whether the phase in periods are longer. The benefits of US market access and the promise of increased US FDI will dominate potential costs for Vietnam, but not necessarily in the case of China.

The United States has been pushing for more regulatory discipline for state-owned enterprises (SOEs) in the negotiations and, in particular, competitive neutrality between SOEs and private enterprises in member economies (Barfield, 2011). Vietnam and Malaysia are the two current members in which SOEs are dominant or prominent. The political implications of others seeking to set rules for the management of SOEs would be even more significant for China. Reforming SOEs and the privatisation process is a deeply domestic issue that will not be resolved quickly.

China will only join on its own terms. The WTO accession experience shows that locking China into reforms can only occur, especially now given its size, when it is using external institutions as tools in its own interest to open up and reform its domestic economy. There are pro-reform voices in China that are pushing for entry into TPP negotiations in order to further reform as many of the areas under discussion and

negotiation are priority areas for Chinese reform¹⁰. A TPP agenda and negotiations dominated by the United States, however, is likely to make it difficult for China to join.

If China is ever to accede to the TPP, the agreement would need to be designed with easy accession by China on terms that meet its own interests. Those can bind China to a degree but will only succeed if China can be persuaded to bind itself in those areas and on its own terms. If the TPP ends up being a set of related bilateral agreements, as the United States has thus far revealed a preference for, China will have to negotiate bilaterally with the United States in order to join a broader TPP and that would require separate approval by the United States Congress.

Given some of the rhetoric in the United States, and the content of the proposals put forward by the US negotiating team, Australia and New Zealand have made it clear that they will withdraw from negotiations if the TPP starts looking anything like a China containment policy (Wallace, 2011).

The agreement will have to be structured carefully for easy accession by other large Asia Pacific countries as the expected economic gains for the current members are relatively small without including some of the more dynamic elements in the global economy like Indonesia, China and India.

The TPP has been endorsed by APEC leaders in Yokohama in 2010 as a potential pathway to the realisation of the FTAAP but China objected to the TPP's being identified as the sole pathway towards an FTAAP (Drake-Brockman et al., 2011). China would be one of the most important elements in any FTAAP or any regional arrangement. Not having China participate in the shaping of the TPP will cause resistance to the TPP's being the basis for any FTAAP (Drake-Brockman et al. 2011).

Regional response to TPP

There has been a tactical response to the TPP negotiations from East Asia in the form of recent re-energising of the push towards an East Asian FTA. China and Japan elevated the urgency of the ASEAN+6 member Closer Economic Partnership Agreement (CEPEA), which is now cast in terms of an EAFTA (the original ASEAN+3 nomenclature)¹¹. The ASEAN response is to propose an ASEAN+1 template. Given ASEAN has FTAs with all of the six in the plus-six grouping (Australia, New Zealand, India, Japan, Korea and China) the idea would be to harmonise those arrangements, consolidate them, and then have sign-on for others (the United States, for example). Although neither East Asian response is well articulated, agreed on or entrenched at this stage, they are not favourable developments for the United States.

The CJK FTA between Japan, China and Korea, the 'plus 3' countries, has seen some development with a trilateral summit in Bali around the November EAS meeting and a decision to move ahead with negotiations in 2012. Cooperation of this depth has been

¹⁰ See 'Reform progress puts China on a TPP track', Caixin online, 25 November 2011 <http://english.caixin.cn/2011-11-25/100331554.html> last accessed 29 November 2011.

¹¹ See paragraph 6 of the Joint Media Statements of the 14th AEM+3 Consultations at <http://www.asean.org/26593.htm> where Japan and China released a joint proposal on speeding up the establishment of the EAFTA and CEPEA East Asia agreements. [last accessed 29 November 2011].

difficult for regional rivals, Japan and China, but the TPP, and Japan's interest in the TPP, has created impetus for binding and more formal agreements between them.

Competing models within the Asia Pacific will only work if they do not exclude members or make it difficult for others to join. A TPP that is not designed with new membership in mind, or an East Asian bloc, no matter how small, that the Pacific neighbours could not join, will only fragment regionalism and trans-Pacific integration. Large countries in the region will find it difficult to join an agreement that has already been finalised and which it has not been involved in shaping.

Combining two FTAs is hard enough; it will be very difficult to consolidate or join two exclusive blocs within the region.

Strengthening East Asian cooperation in one form or other will give East Asia, importantly China, leverage vis-à-vis the United States, and could create competition between each for exclusion of the other from its favoured regional trade arrangement. More optimistically, the result could be an alternative and more attractive model for broader regional integration. But complications will arise with any TPP that does not include China. The political reaction to any trade agreement that includes China and Japan and discriminates against the United States is also likely to be sharply negative, making it hard to contemplate any APEC-wide agreement.

Any regional arrangement should rather be purposefully designed not to exclude either the United States or China, but to draw them in on their own terms, since the Sino-US relationship is so central to Asia Pacific integration.

The way forward

There is a real danger that an inward looking TPP, which extends benefits only to initial members at the expense of non-members, including some in East Asia, would damage the already weakened global multilateral system. The region's interest lies in protecting the global system which has benefitted it greatly. A stalled Doha round was a widely used excuse for pushing FTAs with political allies but a weakened WTO after the Doha failure is reason to be extremely wary of damaging the global trading system with regionally divisive discriminatory trade arrangements.

The East Asia region's interests lie in the strength of the global system and the final form of the TPP should relate to protecting that system, not serve to undermine it.

Making the noodle bowl more digestible

One of the main stated aims of the TPP is to tidy up overlapping rules of origin. The obvious way forward for that is a common market-access schedule for all TPP members — an approach favoured by Australia, Brunei and New Zealand — but that is at risk because of a US-led compromise made in Brunei in 2009 that allows market access offers on a bilateral basis or to the TPP as a whole (Barfield, 2011). This feature is systemically important as it affects accession. As of April 2011, the United States was making bilateral market access offers to TPP members which did not already have an FTA with the United States, while Australia, Singapore and New Zealand were offering

uniform offers to all TPP members (Barfield, 2011). Bilateral market access offers may be multilateralised down the track, but that is by no means assured.

The United States is pushing for existing bilateral market access schedules to remain in place (Barfield, 2011). There are two reasons for this: to maintain strong IPR and services provisions in its current FTAs and not have them reduced to a lowest common denominator TPP-wide schedule; and to avoid exclusions in current FTAs coming under negotiation (Barfield, 2011)¹². That flies in the face of one of the reasons Australian advocates wanted to prosecute the TPP, namely, so that it could gain greater market access in the United States than it was able to obtain in the AUSFTA. To avoid creating a noodle bowl of overlapping agreements within the TPP would need clear, strong and preferably short schedules written in so as to multilateralise all bilateral market openings.

There are several ways a potential TPP could reduce, if not eliminate, some of the costs of the Asian noodle bowl of tangled FTAs. Menon (2010) assesses the options for this — including consolidating FTAs into a regional agreement; harmonising MFN tariffs; multilateralising preferences; and diluting the rules of origin (with patch work loosening up of the rules of origin). The first option is to consolidate the FTAs by having an agreement that supersedes the bilateral FTAs. The idea would be to have a regional agreement that offers better access and preferences than covered by bilateral agreements. For example, if the TPP was more liberal than AUSFTA or any other bilateral within the TPP, there would be no need for bilateral preferences. But that would be difficult given how different many of the FTAs are in the region, and there are more examples of bilateral deals within regional deals offering better preferences (Menon, 2010). Importantly, consolidation of FTAs would necessarily create a trading bloc which is in nobody's interest. Consolidation within East Asia will be economically weak with only 6 per cent of the total number of FTAs that the members are involved in, and 23 per cent for ASEAN+6, but it would send a very strong symbolic message to non-members. Consolidation of FTAs within TPP would simplify rules of origin but the TPP would still be a trading bloc – at least a less messy one – and further fragment the global trading system. A strategy of consolidating FTAs already looks complicated with the United States wanting to keep its bilateral carve-outs in the TPP negotiations.

A better option would be to multilateralise the FTAs by phasing out preferential tariffs on an MFN basis (Menon, 2010). With this strategy, the United States and others will lose bargaining coin in negotiations as well as the leverage of the domino effect that comes from market access to the US market. But with a weakened WTO, some bold leadership in Asia in the name of global welfare improvement could be useful. It is often lost or forgotten in thinking about trade negotiations or trade policy that by far the largest gains accrue from what you give up, not what you extract from others in a negotiating framework.

The difficulty in trade policy initiatives lies in the fact that their costs are incurred early and are concentrated whereas benefits are spread over time and over the whole economy. Yet East Asian economies, including through APEC, have had much experience at fighting domestic vested interests and liberalising unilaterally. The greatest

¹² There are reports that US negotiators have insisted market access schedules in existing US FTAs will not be re-opened in the TPP (*Inside US Trade*, 18 June 2010).

liberalisations in trade and investment happened on a unilateral basis for most East Asian economies, supported by commitment through APEC (Elek and Soesastro, 2011). Commitments through TPP could act as a catalyst or sustain domestic reform efforts if structured correctly (Findlay, 2010).

The multilateralisation of preferences and preferential treatment need not be limited to tariffs. Despite the evidence that preferential services commitments do not deliver much in terms of liberalisation (Francois and Hoekman, 2010), some gains can be made by multilateralising preferential service sector accords and this is relatively easy to do with the preferential accords in place (Lloyd, 2002; Hoekman and Winters, 2007).¹³ That will be a matter of extending the existing regulatory access to others whether it is in the areas of government procurement, competition policy or foreign investment restrictions (Menon, 2010). Those are 21st Century trade issues that are important for integration and the equal treatment of foreign and domestic firms.

It would be difficult to multilateralise the so called "platinum"-standard conditions in a TPP except for requiring all countries to adopt them. Yet that would be difficult given the resistance even from developed countries (Australia and New Zealand) and the difficulty in implementing in developing countries (Vietnam, Malaysia and potentially China). The resistance would be due not only to the fact that it is not part of the region's priorities, but mainly because it is not in the region's interest or the interest of the individual countries in East Asia.

The option for harmonisation of MFN tariffs can help untangle the rules of origin problem and reduce the preference margins although that does not deal with non-tariff barriers, investment or services liberalisation (Menon, 2010). And neither does the dilution of rules of origin option but both are improvements on the current inefficient rules of origin from the tangle of FTAs.

The politics of multilateralising FTAs will be difficult, if not impossible in the US Congress, but with this strategy having the largest potential welfare gains, perhaps it is time that the economics dominated the politics in the Asia Pacific again and through the TPP, leadership is shown as that once again, the economics is the politics.

An inclusive and balanced agenda

The TPP could either become economically insignificant like most other FTAs; it could become the agreement with platinum standards that the United States is pushing for and others find difficult to join; or it could focus its agenda on the things that matter for economic integration across Asia and the Pacific. The latter outcome would also contribute to the buttressing the global trading system.

The worst case scenario would be an agreement with so called "platinum" standards, exclusions of sensitive sectors (without phase out of protection), and locking in preferential access for services and investment (without liberalisation beyond what is already on offer). Those issues relate to the agenda and that may be the most likely outcome but it is an outcome that should be strenuously avoided.

¹³ As mentioned above, there is little to no evidence of multilateralising preferential service access through negotiation outside of the EU but that is no reason for the TPP not to be ambitious in this regard.

First, on the "platinum" standards, in order to conclude **negotiations**, some of the requirements such as IPR protection, investor state dispute settlement, and labour and environment standards might have to be watered down significantly (Solis, 2011) or dropped completely. Many countries in East Asia may not be able to agree to high quality "gold" standard, or "WTO-plus" provisions, let alone standards that meet American requirements. Inclusion of "platinum standards" could be viewed as a veto on any new member not willing to agree to those conditions.

The "platinum" standards would have minimal economic benefit and would be politically divisive as certain non-members will find it difficult to join. IPR protection is important in global commerce, but what is currently being negotiated does not reflect a reasonable balance interests on IPR, even for countries with already strong IPR protection regimes like Australia and New Zealand. The TPP outcome has to be conscious of that and not let the issue become divisive and punitive for developing countries.

Second, on liberalising agriculture and other border barriers, the track record of FTAs shows that they start out ambitious but that what is delivered in the way of economic gains does not match the rhetoric. They are full of exclusions of the sensitive sectors that matter. The more countries involved in negotiating, the more diverse interests there are, and the risk of a lowest common denominator agreement with exclusions is higher. For the TPP to contribute positively to regional economic integration, it needs to get real progress on important issues while incorporating developmental concerns and transparent but strong phasing in schedules for implementations for politically difficult sectors, such as agriculture. The alternative to the phase-in schedules are exclusion, which will weaken the rationale and potential economic benefits of TPP.

Third, services and investment is also an area where there is potential that the TPP to achieve more than FTAs have in the region. The first best solution is for regulatory and domestic reform issues to be delinked from preferential agreements (Findlay, 2010; Elek, 2010) but if the TPP can promote **non-discriminatory** liberalisation, then non-members will benefit as well as members. This would simplify the problem of new member accession and will mean that domestic reforms driven by TPP will serve to narrow the gap between members and non-members instead of widen it (Findlay, 2010).

Member countries can use commitments made through TPP to push their own domestic reform agendas. Some in Japan see the TPP as the best chance at breaking open the agricultural liberalisation deadlock. There is potential for China to reform its SOE sector using TPP as a tool but that would only work if China puts that issue forward as a priority itself. Deeply domestic reform issues cannot be imposed from the outside, but outside pressure can be mobilised to help make progress on them.

The agenda has to focus on those areas that countries are looking for reform and support on liberalisation, as well as serious consideration of how to multilateralise goods and services trade preferences in the region. The TPP initiative could be used to make real progress on identifying behind the border regulatory and institutional impediments to trade, discussion of investment and services liberalisation on a beyond-preferential basis and how to support domestic reforms that countries want to carry out

that will affect TPP partners. That will be crucial to get proper buy-in for SOE reform in China and agricultural reform in Japan, for example.

Progress with the TPP, and how it is managed, is important to the global trading system, especially post-Doha. A major regional agreement such as this now needs to be tied to buttressing the global trading system and supporting multilateral outcomes. A clear agreement on multilateralisation of preferences, both in tariffs and non-tariff areas such as services, as an eventual goal and commitments to open the region would be significant positives for the multilateral system.

Accession for new members

To avoid the risk of becoming an exclusive grouping that key countries find difficult to join, the best outcome for the TPP could be an agreement that has multiple speeds of implementation and multiple tracks or tiers for the economies in the region at different stages of development facing different issues. But that is a very unlikely outcome as it would require very strong, transparent automatic or easy sign-on provisions.

There is the issue of whether large Asian economies will be willing to join the TPP if the principal negotiation of its terms is done before they join and the final deal set in concrete without their input (Barfield, 2011). One solution would be to have non-members join negotiations as observers, although that would be difficult to realise and may not solve the potential member/non-member divide.

Expansion of membership, and creating an inclusive agreement is where the potential economic benefits lie and that aim of the TPP should remain a priority. Easy expansion of membership is one of the biggest challenges for TPP, a challenge that requires careful thought. The risk is that, once an agreement is negotiated, sign-on by non-members in the region (an explicit goal) will be difficult with extra requirements for new members and individual veto over new membership, for example, by the United States. If the agreement requires consensus from members (or incumbents) there is effective veto-power built into new membership (Hamanaka, 2010).

A transparent and established process with clear criteria for application of membership is needed for two reasons. First, it will give members less discretion over the conditionality they can add to individual members for accession (Hamanaka, 2010). Second, a membership bid should not have to be triggered by an invitation from members. The requirement of an invitation creates maximum discretion for members and is not congenial to expanding membership (Hamanaka, 2010). But automatic sign-on is not constitutionally easy for the United States given Congress has to approve each new member separately.

It will be tempting for members to try to extract more concessions from potential members than they conceded in creating the TPP and use membership of the "club" as leverage. But for the TPP to be a building block for regional integration that also contributes to global economic integration, potential new members have to be able to join on the same terms as the foundation members (Findlay, 2010). That would be difficult if the agreement is full of bilateral deals and exemptions and rules of origin designed to limit any competition from non-**participants**. Ideally, potentially interested

members should be able to review the rules to plan their membership bid (Findlay, 2010).

There is strong incentive for the final agreement to require negotiation with new members one by one instead of having accession on a uniform set of previously agreed rules, even if there are different tiers or timetables for accession. If accession for future members has to be negotiated separately with each member, that would be a laborious and counterproductive process which would build layer upon layer of exclusions, exemptions and protection. It will leave power of veto for economic, political and whatever reasons with individual original signatories (Armstrong, 2011). There should be a clear and explicit aim not to create barriers to accession that have to be negotiated separately with every member.

Ideally, although it is politically difficult, for the TPP to contribute regionally and globally, there should be automatic sign-on provisions for third party countries, even those outside the Asia Pacific region (Armstrong, 2011). If TPP members reduce trade barriers significantly and remove behind-the-border barriers in sensitive sectors, extending membership to others who are prepared to do likewise on the same terms (in respect of phase-in and all other conditions) should be automatic. There is no reason why, for example, Japan, should it succeed in opening up its agriculture to the United States and Australia through joining TPP, would want to withhold its concessions from others in South America, Europe or Africa, who were prepared to scrap tariff barriers, and undertake other reforms required of eligibility for TPP membership should they wish to take that step.

If APEC is the vehicle chosen for launching even if not prosecuting TPP, it would be prudent to frame it as an arrangement that is open to all APEC members and globally, consistently with APEC modalities and success thus far.

Conclusion

The TPP has the potential to be a significant agreement that can further economic integration in East Asia and across the Pacific, and keep the United States engaged in the region. But it faces many challenges in its aim to become a truly 21st Century agreement that connects the region together.

To avoid becoming a narrow, economically insignificant agreement that politically divides the region, there are a number of key requirements that a final TPP agreement would have to meet.

The TPP should be tied to buttressing and supporting the global trading system and multilateral outcomes. At this stage it is still unclear whether the TPP will become a stepping stone (or building block) towards regional economic integration or whether it will be a barrier. And then there is the priority of having a form of regional economic integration that does not detract from, but instead furthers, global economic integration. Multilateralising FTAs or preferences and extending MFN treatment to others will be very difficult and take time. But a starting point should be making that an explicit ultimate aim and also making sure that preferences within the TPP are multilateralised. It does not help to add more bilateral preferences *within* the TPP, which is what it now seems likely to do.

To reduce the risk of the TPP's becoming an exclusive club that is inward-looking and that damages the global trading system, it should have phase-out periods for preferences that deliver eventual equal treatment of non-members. The goal needs to be re-phrased, not in terms of market access in foreign countries (although the political economy of it may require phrasing in that manner) but in terms of further opening up of economies at home, increased competition in services and opening up of investment, and reforming domestic regulatory processes in order to make markets more efficient and contestable. The main gains from trade come from what is done domestically. Asia should be investing in those domestic reforms at the same time as reinventing the WTO for the 21st Century so that it promotes the positive elements of the TPP multilaterally.

The TPP should focus on issues of importance to the ongoing regional integration process. These have to do with regulatory coherence, rules of origin, increasing transparency, competition policy, mutual recognition of qualifications and services aspects of supply chains. Those issues are currently under negotiation in the TPP but they are smothered by a US-led agenda on IPR, labour and environmental standards that is not consistent with the regional integration agenda directed at further expanding, and deepening of, regional supply chains and that has to account for economies at different stages of development and transitioning at different speeds.

TPP needs to work to multilateralise and connect the current overlapping agreements, not add to its complexity with bilateral deals within the TPP itself.

And to avoid excluding key countries from participating, TPP needs clear accession protocols that are transparent and robust. That includes avoiding giving individual members veto power on new membership bids.

It is in no country's interest to end up with a deal that excludes China. Or for the East Asian arrangements to proceed in a separate direction from the United States or TPP. China needs to join the TPP on its terms that meet its interests and those of other members and it is in the members' interests to ensure that the deal is negotiated with this as an explicit goal.

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