

## **Evolution of the Asia-Pacific Trade Architecture: Stocktake and Future Outlook**

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### **Abstract:**

One of the key sets of questions underlying Asia Pacific economic cooperation over the last decade has been over the nature and form of the regional trade architecture that would gradually emerge from the turmoil of the Asia-Pacific “noodle bowl” of bilateral and plurilateral FTAs, and how that architecture would accommodate the separate impulses of East Asian and trans-Pacific economic integration.

Calls for East Asian economic integration took center-stage in the wake of the East Asian economic crisis of 1997/98, and were quickly reflected in the proposal for an East Asian Free Trade Area (EAFTA) based on the ASEAN plus Three groups. The subsequent development of the so-called “ASEAN Plus One” FTAs both provided a feasible way forward in the absence of a politically viable basis for integration among the major Northeast Asian economies, and also entrenched the idea of East Asian economic integration as an “ASEAN-centered” process. Japan’s proposal for a Comprehensive Economic Partnership for East Asia (CEPEA), based on an ASEAN plus Six groups of countries that comprised the then membership of the East Asian Summit (EAS), subsequently provided an alternative configuration for a region-wide trade bloc based on East Asia. Since then the EAFTA and CEPEA initiatives have moved forward in parallel, but no agreement has been reached to commence formal negotiations in either case.

This paper has presented the state of play and future outlook for each of the three initiatives as they appeared at the time of the 2010 APEC leaders’ meeting. This has been followed by a discussion of developments in these initiatives in 2011, as well as possible implications for these initiatives of developments in other arenas.

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## 1. Introduction

The trans-Pacific approach to regional economic integration, which appeared to have been eclipsed by the East Asian developments, was revived by the ABAC (APEC Business Advisory Council) proposal for a Free Trade Area of the Asia Pacific (FTAAP), which after some initial hesitation was strongly endorsed by the United States at the APEC Economic Leaders Meeting in Hanoi in 2006. At that time the apparent clash between the East Asian “vision” embodied in the EAFTA and CEPEA proposals and the trans-Pacific “vision” reflected in the FTAAP was resolved within APEC by a compromise whereby APEC formally adopted a Regional Economic Integration (REI) agenda in which the FTAAP was recognized as a “long-term” prospect. The absence of a credible vehicle for the trans-Pacific approach to regional trade liberalization was remedied in 2008 by the emergence of the Trans Pacific Partnership (TPP) initiative, which formally involved converting a somewhat obscure trade agreement (the Trans Pacific Strategic Economic Partnership or TPSEP) among four small APEC member economies into a potentially much more significant region-wide trade agreement involving also the United States and Australia as well as Perú, Vietnam and later Malaysia. The commencement of formal TPP negotiations in early 2010, and the openly declared ambition to draw in further APEC members as participants, focused attention squarely on the TPP as a potential building block for the FTAAP and confronted other APEC members with the need to define their position toward this new development.

The 2010 APEC Economic Leaders Meeting appeared to mark an important step toward resolving the question of how these separate East Asian and trans-Pacific initiatives would be reconciled in promoting the future evolution of the future trade architecture of the Asia-Pacific region. In the leaders’ 2010 statement the status of the FTAAP is elevated from that of a “long term prospect” to that of “a major instrument to further APEC’s Regional Economic Integration (REI) agenda”. The FTAAP is to be “translated from an aspirational to a more concrete vision.” The leaders further declare that the FTAAP is to “be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership, among others.”

The leaders have thus unambiguously endorsed the FTAAP as the end-point to be reached in the evolution of the Asia-Pacific

regional trade architecture. At the same time they have given equal endorsement to the EAFTA, CEPEA and TPP initiatives as the building blocks from which the FTAAP may be developed. In doing so, they have clearly posed a challenge to the promoters of these three initiatives. If the TPP is to play the leading role in the genesis of the FTAAP it will have to attract additional participation from leading East Asian APEC members in both Northeast and Southeast Asia. In order for EAFTA or CEPEA to play that role ways will have to be found firstly to overcome the obstacles which have so far prevented those two initiatives from proceeding to the stage of formal negotiations, and ultimately to widen participation to include the rest of the APEC membership.

At the time of the 2010 APEC leaders’ meeting it was arguably possible to put forward a reasonably clear assessment of the state of play in each of the three initiatives, the challenges that they each faced, and the factors that would be important in determining whether and to what extent those challenges would be successfully overcome. Since then economic and political developments at both the regional and global levels have arguably changed somewhat the outlook for each of these three initiatives.

The paper will now proceed as follows. First a brief assessment will be presented of the state of play and future outlook for each of the three initiatives as they appeared at the time of the 2010 APEC leaders’ meeting. This will be followed by a discussion of developments in these initiatives in 2011, as well as possible implications for these initiatives of developments in other arenas.

## 2. Issues in the Evolution of East Asia’s Trade Architecture

The ASEAN plus Three (APT) group, formed in the aftermath of the East Asian economic crisis and comprising the ten members of ASEAN plus China, Japan and Korea, remains one of two groupings whose agenda focuses on region-wide economic integration in East Asia. Understandably in view of its origins in the East Asian response to the crisis, the APT agenda has from the beginning included a strong focus on monetary integration. The main products of this focus to date have been the Chiang Mai Initiative (CMI) and its subsequent multilateralization, and the rather less well defined Asian Bond Market Initiative (ABMI). There has also been ongoing discussion in “think tank” circles on the possibility of creating

an “East Asian currency unit” as a unit of account in East Asian economic transactions, and possibly also some form of exchange rate coordination. Trade was also included in the APT agenda at an early stage, via the proposal for an East Asian Free Trade Area (EAFTA). Studies on this proposal by both an East Asian “Vision” Group and successive study groups have resulted in recommendations that EAFTA should have a central role in East Asian economic integration, and working groups have been formed to prepare the way for eventual negotiations. Conceptually, the establishment of EAFTA could be viewed as broadening the integration achieved within ASEAN through the ASEAN Free Trade Agreement (AFTA, later known as the ASEAN Trade in Goods Agreement, or ATIGA), to incorporate the three major Northeast Asian economies, China, Japan and Korea. It was obvious from the beginning that establishment of a viable basis for economic integration among these three Northeast Asian economies would be among the most difficult challenges to be faced in achieving this transition, given the longstanding political and economic sensitivities and antagonisms in relation between them.

In moves that could be interpreted partly as ways of sidestepping the issue of economic integration between themselves, and partly as expressions of the rivalry between them, the three major Northeast Asian economies, China, Japan and Korea, each focused in the early years of the twenty-first century on establishment of their individual “ASEAN Plus One” FTAs with the ASEAN group. The successive establishment of the ASEAN-China FTA (ACFTA), ASEAN-Korea FTA (AKFTA) and ASEAN-Japan FTA (AJFTA) was accompanied by entrenchment of the understanding that ASEAN should play the central and leading role in East Asian economic integration. For ASEAN this understanding took on something of the character of a fundamental non-negotiable principle, while for the three Northeast Asian economies it was a convenient mechanism that allowed them to avoid resolving leadership issues among themselves.

Concerns over the potential dominance of the APT group by China, especially on the part of Japan, were one of the motivations behind the decision to establish an East Asian Summit (EAS) with expanded membership. Japan is known to have favoured inclusion of the United States as a foundation member of the EAS, but in the end the East Asian economies looked south and west for the expanded membership of

the EAS, by including Australia, New Zealand and India in an EAS group that has also been known as “ASEAN Plus Six”. ASEAN subsequently moved to conclude “ASEAN Plus” FTAs with the additional three members of the “ASEAN Plus Six” group, leading to establishment of the ASEAN Australia New Zealand FTA (AANZFTA) and the ASEAN-India FTA. The “ASEAN Plus Six” group has thus emerged as an alternative to the APT group as the vehicle for region-wide economic integration in East Asia. It has been generally understood that Japan prefers the “ASEAN Plus Six” group for this role while China prefers APT.

The economic agenda of the ASEAN Plus Six group centers on the concept of a Comprehensive Economic Partnership for East Asia (CEPEA), strongly promoted by Japan and supported by a substantial Japanese financial commitment to a CEPEA-related research program implemented through the Economic Research Institute for ASEAN and East Asia (ERIA), located alongside the ASEAN Secretariat in Jakarta. The CEPEA concept includes an FTA among the ASEAN Plus Six members. Where the APT focuses on monetary integration as a key complement to regional trade and investment liberalization, CEPEA places more emphasis on development of regional infrastructure and supply chain connectivity. ERIA’s research agenda also includes a strong emphasis on supporting the realization of the ASEAN Economic Community (AEC).

For some time the work programs associated with the EAFTA and the CEPEA FTAs proceeded separately and in parallel, each with their own working groups, which not surprisingly had overlapping agendas. In 2009 a decision was taken to merge the working groups for the two initiatives. ASEAN was given the responsibility of bringing about this merger of working groups. Progress to date on achieving the merger has been slow.

Two issues stand out in assessing the prospects of moving forward to establish either the EAFTA or the CEPEA. These are, first, the establishment of a feasible way forward to achieving economic integration in Northeast Asia, and second, the role of ASEAN as leader of the process.

The three major economies of Northeast Asia account for around 90% of East Asian GDP, and the trade flows between them are the largest and most important in East Asia. The lack of economic integration arrangements among these three economies thus stands out as

a major gap in the matrix of East Asian bilateral trade flows covered by preferential trade agreements. Moving from the current array of "ASEAN Plus" FTAs to a single EAFTA or CEPEA FTA necessarily requires that this gap be filled, either as part of the process of establishing the EAFTA or CEPEA, or by the establishment of a Northeast Asian FTA as a prelude to the conclusion of either of the East Asian region-wide agreements.

In fact the issue of Northeast Asian integration has never been an entirely neglected facet of the East Asian regional integration process. Japan and Korea announced in 1998 that they would explore the possibility of an FTA between themselves, and FTA negotiations subsequently commenced, although they were later suspended, reportedly over reluctance by Japan to open its agricultural market to Korean exports. It is known that more recently a "track two" study has been completed of a possible China-Japan-Korea (CJK) FTA, and that studies have been undertaken in both China and Korea on a possible China-Korea FTA.

The obstacles however, either to a CJK FTA or to agreeing terms for trade liberalization between China Japan and Korea in the context of EAFTA or CEPEA, remain formidable. The political sensitivities in relationships between the three countries are well-known. In each country the perceived competitive threat to domestic industries represents a further serious political economy difficulty. Japan and Korea for example are concerned about the impact on their agricultural sectors, while China and Korea are concerned about the impact on some of their manufacturing industries, for example the motor vehicle and chemical industries in the case of China.

A recent development that injects a new potential dynamic into the Northeast Asian equation is the conclusion in 2010 of an Economic Cooperation Framework Agreement (ECFA) between China and Chinese Taipei, which is perceived in some quarters in Korea in particular as a significant competitive threat, because of the extent of direct competition between Korea and Chinese Taipei in the Chinese market. Reports from Korea towards the end of 2010 indicated that Korea may be leaning toward moving immediately to negotiate an FTA with China, rather than wait for a CJK accommodation. Such a move by Korea would not be welcome to Japan, which would then find itself under pressure to counter this development by moving forward more quickly than it might wish on economic integration with China in particular but also with Korea. The

conclusion of the ECFA thus appeared to have the potential to have a catalytic effect on economic integration in Northeast Asia, and consequently on the overall process of East Asian economic integration.

Another regional significance of the ECFA is that it may open the way for greater participation by both Chinese Taipei and Hong Kong in the process of East Asian regional economic integration. China has hitherto been strongly opposed to FTAs between Chinese Taipei and other Asia-Pacific economies, but it has reportedly signaled that following the conclusion of the ECFA it will no longer oppose such FTAs, provided the formula followed in the WTO, where Chinese Taipei participates as a separate customs territory, is also observed in each FTA, and provided that Chinese Taipei's partner in each case already has a bilateral FTA with China. Relying on this signal, Singapore is reported to have moved immediately to revive an earlier aborted proposal for an FTA between itself and Chinese Taipei.

Opening participation in East Asian regional economic integration processes to Chinese Taipei and Hong Kong would be a significant development. Both Chinese Taipei and Hong Kong are major players in East Asian trade, and their exclusion to date from both the EAFTA and CEPEA processes has represented a substantial limitation on the scope of the economic integration that the region has been able to contemplate.

Increasing recognition of the centrality of progress toward economic integration in Northeast Asia for the overall process of East Asian integration has perhaps inevitably been accompanied by an increasing tendency to question both the capacity and appropriateness of ASEAN in the role of leader of the East Asian process. Acceptance of ASEAN leadership and "ASEAN centrality" has hitherto suited the purposes of both ASEAN and the Northeast Asian economies. As and when concrete steps begin to be taken to break the impasse in Northeast Asia the centre of gravity of the East Asian integration process is however likely to shift to Northeast Asia and there would be a natural tendency for leadership of the process to shift with it. ASEAN may find it difficult adjust to this shift. There have been questions however, not least within ASEAN itself, over whether ASEAN has sufficient internal cohesiveness to form a united view on how to move East Asian integration forward, especially when the principal issues being addressed concern integration in Northeast Asia. The incentive for ASEAN to move from the

current array of “ASEAN Plus” FTAs to an EAFTA or CEPEA FTA may also be questionable, since the move may involve some erosion not only of ASEAN’s leadership status but also of its preferential access to the markets of its APT or EAS partners.

ASEAN members have recognized that achieving greater progress in integration among themselves is both important to the credibility of ASEAN’s role as leaders in the East Asian integration process, and also necessary for their own successful adjustment to a possible East Asia-wide trade agreement. This recognition provided an important element in the motivation for the decision by ASEAN members to commit themselves to establishment of the ASEAN Economic Community (AEC), essentially an ASEAN single market, by 2020. The target date for achieving the AEC was later brought forward to 2015. It may be rational for ASEAN to prioritize establishment of its own ASEAN Economic Community over EAFTA or CEPEA, but this may not be helpful in moving the East Asian integration process forward in the short term.

Another issue that initially tended to lurk in the background of the East Asian economic integration process but has more recently moved to centre stage is how East Asia should manage the implications of its own integration for its relationship with the United States, traditionally of fundamental importance to East Asia both because of the United States’ status as a crucial market for East Asian exports and a major source of foreign direct investment in East Asia, and because of the vital role played by the United States in the region’s security architecture. The United States could not be expected to welcome being discriminated against by an emerging East Asian economic bloc. One solution that has been often suggested in East Asian circles is the adoption of a sequential approach, whereby EAFTA is launched first, to be followed by a move to CEPEA once EAFTA is operating successfully, with establishment of an Asia-Pacific-wide FTA (the Free Trade Area of the Asia Pacific or FTAAP, discussed in the next section of this paper) to follow as the final step. It may not however be realistic to expect that the United States will readily accept a sequencing that would require it to suffer discrimination for several years while East Asian integration is being established, before finally being invited to join the process itself.

### 3. Evolution of the TPP and its Role in Asia-Pacific Economic Integration

As noted above the present TPP process developed out of an FTA between four small Asia Pacific economies, the Trans Pacific Strategic Economic Partnership (TPSEP) or “P4” agreement between Singapore, Chile, New Zealand and Brunei.<sup>2</sup> This relatively obscure agreement was transformed into a potentially major element in the development of the Asia-Pacific regional trade architecture by the United States’ announcement in September 2008 that it would negotiate to join the TPSEP.

In November 2008 Australia and Perú announced that they too would join negotiations to forge an expanded agreement, which from that time onward has been known simply as the TPP or Trans-Pacific Partnership. After a delay following the 2008 United States presidential election, in late 2009 President Barack Obama confirmed that the United States would “engage” with the process of shaping the expanded agreement. At that time the TPP was the first significant trade initiative that the Obama Administration, elected a year earlier, had committed itself to pursue. In March 2010 TPP negotiations formally commenced among the United States, Australia, Perú and the four foundation members of the TPSEP, Singapore, New Zealand, Chile and Brunei, with Viet Nam also participating in the negotiations as an observer. A quick pace in the negotiations was set from the beginning, with four negotiating sessions being held during 2010. At the third negotiating session Malaysia announced that it would join the negotiations as a full participant.

Of the thirty six bilateral relationships or dyads among the existing nine TPP participants, only eleven are not already covered by an existing FTA relationship, and the latter are generally of only minor trade importance to at least one and sometimes both of the countries involved. Figure 1 summarizes the extent to which bilateral trade between TPP participants is already covered by existing FTAs. Malaysia, New Zealand, Viet Nam and Brunei are the participants for whom the TPP as currently configured potentially offers the most significant “prizes”, in the form of new FTA relationships with the United States, but these four economies account for only a tiny share of United States trade.

<sup>2</sup> For background on the genesis of the P4 and its subsequent evolution, see Scollay (2010).

	USA	Australia	Singapore	Chile	Peru	NZ	Viet Nam	Brunei	Malaysia
USA		<i>Bilateral</i>	<i>Bilateral</i>	<i>Bilateral</i>	<i>Bilateral</i>				
Australia	<i>Bilateral</i>		<i>Bilateral</i> <i>AANZFTA</i>	<i>Bilateral</i>		<i>Bilateral</i>	<i>AANZFTA</i>	<i>AANZFTA</i>	<i>AANZFTA</i>
Singapore	<i>Bilateral</i>	<i>Bilateral</i> <i>AANZFTA</i>		<i>TPSEP</i>	<i>Bilateral</i>	<i>Bilateral</i> <i>TPSEP</i> <i>AANZFTA</i>	<i>AFTA</i>	<i>AFTA</i>	<i>AFTA</i>
Chile	<i>Bilateral</i>	<i>Bilateral</i>	<i>TPSEP</i>		<i>Bilateral</i>	<i>TPSEP</i>		<i>TPSEP</i>	
Peru	<i>Bilateral</i>		<i>Bilateral</i>	<i>Bilateral</i>					
NZ		<i>Bilateral</i>	<i>Bilateral</i> <i>TPSEP</i> <i>AANZFTA</i>	<i>TPSEP</i>			<i>AANZFTA</i>	<i>TPSEP</i> <i>AANZFTA</i>	<i>AANZFTA</i>
Viet Nam		<i>AANZFTA</i>	<i>AFTA</i>			<i>AANZFTA</i>		<i>AFTA</i>	<i>AFTA</i>
Brunei		<i>AANZFTA</i>	<i>AFTA</i>	<i>TPSEP</i>		<i>AANZFTA</i>	<i>AFTA</i>		<i>AFTA</i>
Malaysia		<i>AANZFTA</i>	<i>AFTA</i>			<i>AANZFTA</i>	<i>AFTA</i>	<i>AFTA</i>	

**Figure 1: Coverage by existing FTAs of bilateral trade between PPT participants**

*Source: Author*

In fact the seven economies that joined the United States in the opening TPP negotiations at the beginning of 2010 account for only 4% of United States' trade. Thus the TPP, in establishing a limited number of new bilateral FTA relationships, clearly does not signify a dramatic increase in the overall coverage by FTAs of trade between the current participants, although it may of course also extend the trade coverage of some existing FTAs and is certainly intended to add new dimensions to some if not all of them. In particular, trade potential with the existing TPP members clearly does not explain the level of commitment of the United States to the TPP.

The real significance of the TPP arises of course from its potential as a "stepping stone" to the FTAAP. It is the inclusion of the additional participants that may be attracted into the TPP in future, especially major economies in Northeast Asia, that offers the greatest economic benefit to the United States and several of the other current participants. Strategically, as Barfield and Levy (2009) explain, the TPP is intended by the United States as the vehicle for maintaining the trans-Pacific link as an integral element of the Asia-Pacific regional trade architecture, an objective shared of course by the other participants. In effect, the TPP is today's expression of the original APEC rationale of ensuring that there is no "line drawn down the middle of the Pacific".

The TPP is formally open to additional participants. The existing participants have

established ground rules that new participants are expected to accept. It is common ground among existing participants that the TPP should be a "high quality" "twenty-first century" agreement, and this is interpreted among other things to mean that no issues should be excluded from the negotiations, even if agreement cannot ultimately be reached on all details, including product coverage of the market access provisions. Potential new participants are permitted to attend negotiations as observers for a maximum of three negotiations, after which they are expected to become full participants in order to continue attending.

The TPP negotiation, like any trade negotiation, inevitably involves specific issues that are sensitive to a greater or lesser degree for one or more participants. Likely examples include market access for sugar, dairy products, beef and textiles and clothing for the United States, pharmaceutical purchasing systems for Australia and New Zealand, government purchasing for Malaysia, and intellectual property protection issues for most participants. By the standards of other FTA negotiations the challenges posed by the individual sensitive issues in the TPP do not appear to be especially severe, given the extent to which issues have already been resolved in previous bilateral FTAs among participants, and given also what seems to be a broad consensus among participants that product and issue coverage in the TPP should be as comprehensive as

possible, and that there should be no *a priori* exclusion of any issue. The principal source of difficulty is likely to be the relatively small economic gains anticipated for most participants from the TPP if its membership remains as it is, which implies correspondingly small incentives for the participants to make the effort to reach agreement on their sensitive issues, unless they factor in the potential larger gains from the uncertain prospect of future expansion of the TPP membership.

A key architectural issue that has also had to be faced in the TPP negotiations is whether the TPP should replace the existing bilateral agreements among the participants, or complement them and if so on what basis. This issue of course arises in any initiative that seeks to create a large plurilateral agreement among countries that are already connected by bilateral agreements. It had to be addressed in the negotiations for the Free Trade Area of the Americas (FTAA) and it will also have to be addressed in any future EAFTA or CEPEA negotiations. It was one of the main issues addressed in the initial rounds of TPP negotiations. The extent to which the original "P4" agreement and the participants' other existing agreements, both with each other and with other partners, would be used as sources for text of the TPP, has also been an issue to be gradually resolved in the course of the negotiations.

The emergence of the TPP also helped to bring the issues surrounding the future of East Asia's relationship with the United States sharply into focus. By throwing its weight behind the TPP the United States gave a clear signal of its determination to maintain and deepen its economic engagement with East Asia. Petri (2010) has highlighted the economic imperative underlying this stance, deriving from the need for a sharp increase in United States exports to re-balance the United States economy and restore sustainability in its external position, with East Asia projected to account for by far the largest share (41%) of that increase in exports over the next five years. The strength of this imperative, and the lack of clear alternative routes toward the objective perhaps accounts for the extent of resources devoted by USTR to a domestic outreach program – described by Elms 2010 as "unprecedented" – to build support for the TPP.

At the same time the experience of the global financial crisis served to underline for East Asian economies the extent of their ongoing economic interdependence with the United States (and also with Europe),

contradicting suggestions that the rapid expansion of intra-East Asian indicated that East Asia has been successfully "decoupling" itself from the United States and Europe. Re-assessment of East Asia's economic relationship with the United States was in turn linked to wider questions of the future role of the United States in East Asia, which had come into sharper focus in regional debates sparked by the proposals in 2008 and 2009 of Australia's then Prime Minister Rudd for an Asia Pacific Community and by Japan's then Prime Minister Hatoyama for an East Asian Community, with sharply divergent views being expressed even within the normally cohesive Singapore policy establishment (Tay 2010, Koh 2010).

Concern to ensure that the United States remains engaged in East Asia, arising from both the renewed recognition of the central importance of the economic relationship and the ongoing anxiety of several East Asian governments to ensure the maintenance of a strong United States security presence in East Asia, began to gain ground relative to the desire to build an East Asian economic identity that is independent of United States influence. Support began to grow, not least in Japan following the replacement of Mr Hatoyama by Mr Naoto Kan as Prime Minister, around the view that the apparent desire of the United States to "re-engage" with East Asia should be encouraged. An important upshot was the announcement in late 2010 by ASEAN Foreign Ministers of a decision to invite the United States (along with Russia) to join the East Asian Summit. It remains to be seen whether this development will have any influence on the evolution of the ASEAN-Plus trade arrangements. In the meantime the deposing of Mr. Rudd and Mr. Hatoyama from their respective prime ministerships has been accompanied by an ebbing of the attention paid to the Asia Pacific Community and East Asian Community concepts.

There is little doubt that the success or failure of the TPP will ultimately be judged according to whether in practice it has a catalytic effect on progress toward establishment of the FTAAP. Progressive attraction of new participants is essential if the TPP is to successfully play this role. The importance of potential future participants implies that there is an interesting strategic game surrounding the TPP negotiations.

On the one hand, existing participants have an incentive to consider the interests of potential additional participants. This derives from the peculiarity in the TPP case that the expected

economic benefits of a new trade agreement among the current TPP participants are relatively small, and the larger economic and strategic benefits that are expected to make the exercise worthwhile depend on the future attraction into the TPP of significant new members, especially from East Asia.

This issue is relevant to the choices to be made in designing the TPP. In particular it is well known that the United States has an established “template” that it seeks to apply in all its FTAs, as it has done in each of its four bilateral FTAs with current TPP participants, with only limited “customisation” to cater for the particular sensitivities and circumstances of each bilateral partner. Furthermore the “template” tends to become more demanding over time as it incorporates additional features that the United States secures in each new FTA, as has occurred with the KORUS FTA. There have been signs that United States may resist major deviations from its template in the TPP case. On the other hand, not only are there elements of the United States template that are unpalatable for each of the other TPP participants, but, more importantly, basing the TPP too rigidly on the United States template could reduce its attractiveness to additional participants in East Asia, thus potentially reducing the expected economic and strategic benefit from the TPP for its current participants. The intellectual property component of the United States template may be a particular sticking point for some potential new entrants from East Asia.

The negotiators thus face the challenging task of crafting an agreement that simultaneously meets the aspirations of the participants for a “high quality” agreement, satisfies the fundamental interests of the current participants to an acceptable degree – and in particular satisfies United States preferences to an extent sufficient to secure political acceptance in the United States – while avoiding features likely to become unnecessary impediments to expanding the membership of the agreement.

Potential new members of the TPP also have choices to make. While the TPP is likely to be formally open to accession by new members at any time, as was also the case with the original “P4” agreement, the ability of acceding members to negotiate revision of the terms and conditions of the agreement is likely to be limited. Their ability to influence the design of the agreement will be greatest if they participate in the current negotiations, which would allow them to exploit the bargaining power that

derives from the incremental economic gains that would flow from their inclusion in the TPP. On the other hand, meeting the conditions required for participation in the TPP negotiations will often face them with the need to make decisions that are unpalatable in the domestic political context. This consideration appears to have deterred Canada from seeking early participation in the TPP negotiations and also led to a polarizing debate in Japan.

During the latter part of 2010 a groundswell of opinion in favour of Japanese participation in the TPP began to develop within the Japanese business sector and large parts of the Japanese policy establishment, reacting to the economic and political implications of the TPP as well as developments elsewhere such as the reaction in Northeast Asia to the conclusion of the ECFA between China and Chinese Taipei. In early October 2010 Japan’s Prime Minister made a statement indicating that the Japanese government was seriously considering participation in the TPP, with a possible announcement to this effect to be made at the APEC Economic Leaders’ Meeting in Yokohama. This sparked a furious response from agricultural interests in Japan, who mounted a fierce campaign against Japanese participation. In the event Japan’s Prime Minister Kan announced a compromise outcome at the APEC Leaders’ Meeting, whereby Japan would make its decision on participation in the TPP in mid-2011, and would work during the intervening period on policy measures to assist adjustment in its agricultural sector.

Japan’s decision is important both for Japan and for the TPP’s role as a stepping stone to an eventual FTAAP. In order for the TPP to fulfill this role it is clearly important that it should attract participation by the major Northeast Asian economies. Japan would be the first of these three economies to come on board, and its decision to join might also add decisive weight to Korea’s incentives to participate. Elsewhere in East Asia the Philippines government under newly elected President Benigno Aquino had made statements indicating a serious interest in joining the TPP. This would leave Indonesia and Thailand as the two remaining ASEAN members of APEC yet to indicate a stance toward the TPP.

Looking further ahead the issue of Chinese participation looms as the ultimate challenge for realizing the strategic potential of the TPP as a step in the process towards an FTAAP. Since Chinese participation in the FTAAP is indispensable, there is a strong case for Chinese participation in the TPP if the latter is intended

to form the basis of the eventual FTAAP. On the other hand both the United States and China will have reservations over early Chinese participation in the TPP. It is clear that Chinese participation would greatly complicate the task of the United States Administration in securing passage of the TPP through the United States Congress. From China's perspective the fact that it already has FTA relationships with seven of the nine TPP participants and is in negotiations for an FTA with an eighth (Australia) serves to underscore the obvious point that any decision about its TPP participation is essentially a decision about its trade and economic relations with the United States. China is likely to be wary of anticipated efforts by the United States to secure concessions that China has so far been resisting in bilateral and multilateral forums. At the same time there are risks in deferring Chinese participation. China will understandably wish to have a role in shaping any FTAAP in which it is to participate, and may well be inclined to resist proposals that a TPP in whose negotiations it has played no part should be accepted as the basis for design of the FTAAP. It is clear that China is watching TPP developments closely, and influential figures in China are known to have suggested that China should seriously consider participating in the TPP.

Korea is also known to be maintaining a close watch on the TPP. From one perspective the conclusion of the Korea-EU FTA and the prospective ratification of the KORUS FTA mean that Korea feels little pressure for early participation in the TPP. Decisions by Japan and China to participate in the TPP on the other hand would likely change the calculus of Korea's interest, and tip the balance in favor of Korean participation as well.

The difficulties in achieving economic integration in Northeast Asia will also be relevant here. As in the case of EAFTA and CEPEA, simultaneous participation of the three major Northeast Asian economies in the TPP or subsequently in an FTAAP will imply a need for a viable basis to be found for economic integration among themselves.

#### **4. Developments in 2011: Progress and Emerging Uncertainties**

By unambiguously endorsing the FTAAP as the eventual goal of regional economic integration in the Asia-Pacific, and by giving equal endorsement to EAFTA, CEPEA and TPP as avenues toward the achievement of that goal, the APEC leaders in their 2010 statement

appeared to encourage the pursuit of each of these three initiatives, with the relative influence of each on the ultimate shape of the FTAAP likely to be dependent on the extent of progress made in each case. The competitive dynamic thus established has become an obvious factor influencing the evolution of the East Asian initiatives in particular during 2011. The outlook for the three initiatives has also been influenced by new developments elsewhere.

One such development that may have far-reaching repercussions has been the spectacular failure of economic leadership in the political systems of the European Union and the United States over issues relating to government deficits and debt, and accompanied in the latter's case by a perception that economic decision-making is now paralysed by political gridlock, with impacts on international relationships now carrying even less weight than previously in the deliberations of the US Congress on economic matters. This development will have strengthened already widespread perceptions that the passage of a TPP agreement through the US Congress is likely to be a very difficult and lengthy exercise with uncertain prospects of success. With the US President lacking Trade Promotion Authority, and having no prospect of securing it, there are likely to be also heightened concerns over the extent to which Congress is likely to insist on modifying any agreement that is reached. At the same time some informed observers in the United States continue to insist that the TPP will in fact be able to successfully pass the Congress.

These developments in the United States may in turn have a number of consequences for prospects of widening participation in the TPP. Some APEC economies that have been hesitating over possible TPP participation may be encouraged to think that nothing will be lost by holding back. New doubts are likely to be raised over the reliability of the United States as an economic partner, leading to increased emphasis on the risks rather than the benefits of economic interdependence with the United States. Despite continued emphasis by leading figures in the United States Administration on the United States' commitment to re-engagement with East Asia, perceptions that the United States has become less committed to its economic re-engagement with East Asia may grow at a time when there is a noticeable increase in East Asian suspicions that United States' pursuit of the TPP is motivated more by the aim of dividing Asia rather than of promoting trans-Pacific economic integration

(Cai 2011, Yamazawa 2011). To the extent that all this results in diminished enthusiasm in East Asia for economic engagement with the United States, widening participation in the TPP may become increasingly problematic.

The renewed economic disturbances in the United States and Europe during 2011 have also further underlined the stark reality that weak economic growth is the best that can be expected in both of these advanced economies in the immediate future, and that in the meantime the centre of global dynamism has shifted, perhaps irreversibly, to the emerging economies and to the East Asian emerging economies in particular, with China as the undisputed focal point of this dynamism. These considerations are likely to concentrate the attention of East Asian policymakers on the arguments in favor of prioritizing East Asian integration.

The entry of the United States into the East Asian Summit group may also lead to some adjustments in perceptions in both the United States and East Asia of the importance of the TPP as an instrument of United States re-engagement with East Asia, especially among those who emphasize the security rather than the economic dimension of the need for that re-engagement. While United States presence in the East Asian security architecture continues to be seen as essential both by many East Asian governments as well as by the United States itself, the admission of the United States to the East Asian Summit provides an alternative avenue for pursuing these interests without any necessary requirement to pursue economic engagement at the same time. Utilization of the East Asian Summit as the forum for addressing security issues in East Asia is likely to be congenial to both the East Asia and the United States, in East Asia's case because it ensures that such dialogue takes place within an East Asian institution, and in the case of the United States case because it offers the opportunity for dialogue with India, which is not available for example through APEC. Some East Asian governments may also be inclined to promote the East Asian Summit as an alternative to the TPP as a vehicle for United States economic re-engagement with East Asia.

A fourth relevant development has been the dramatic collapse in early 2011 of any expectation that the WTO's Doha Round can be successfully concluded in the near future. This appears to have produced a decisive shift among opinion leaders towards the FTAAP as the most hopeful avenue for achieving region-wide trade liberalization. In the survey of Asia Pacific

opinion leaders reported in PECC's latest State of the Region report (PECC 2011), the FTAAP is ranked as the most important issue to be considered by APEC leaders at their Hawaii meeting, while the WTO Doha Round has slipped down to third place among the priority issues. PECC reported that business respondents in particular "appear to have given up on the WTO Doha round, ranking it 12<sup>th</sup> out of a list of 23 issues, and instead placing top priority on what is seen by many as 'Plan B' – the FTAAP". This prioritization of the FTAAP is likely in turn to be reflected in increased focus on the three routes to its achievement endorsed by APEC leaders in 2010.

Meanwhile the pace of the TPP negotiations has been maintained or even increased in 2011. Eight TPP negotiating sessions have now been held, with one further round of negotiations, in Lima, remaining to be held before the APEC Economic Leaders' Meeting to be hosted by the United States in Hawaii in November 2011. As has been evident from early on in the negotiations there is no possibility that the final agreement will be concluded by November. Efforts are focused on reaching the point where an agreed outline of the agreement can be announced at the APEC meeting.

The TPP negotiations involve a considerable widening of scope beyond the range of issues covered in the original "P4" agreement (Lim 2011). Investment, financial services, electronic commerce, and telecommunications are issues being negotiated in the TPP that were not included in the "P4" agreement. TPP negotiators are also addressing a range of "horizontal" issues with the declared ambition that the TPP treatment of these issues should extend well beyond anything found in existing agreements. These issues include supply chain connectivity, competitive business development, small and medium enterprises (SMEs), and development. Transparency issues are also understood to be heavily emphasized in the TPP negotiations. There are other issues where the level of commitment being sought extends far beyond that found in the "P4" agreement. These include intellectual property, environment, and labour. The latter two issues will be covered in the TPP in chapters in the main agreement, rather than the Environmental Cooperation Agreement and MOU on Labour that were attached to the "P4".

Negotiating groups have been established to address a wide range of issues, including industrial goods, agriculture, textiles, sanitary and phytosanitary standards, services, investment, financial services, intellectual

property, regulatory coherence, the environment, competitiveness, supply chain development, and small- and medium-sized enterprises, among others.

Approaches to the development of the TPP text have evolved gradually. Preliminary discussions between the original “P4” parties and the United States focused on the extent to which use could be made of the original “P4” text, which is still used as a reference point to some extent for chapters which are common to both “P4” and TPP. Subsequently participants have submitted a range of draft text proposals for many of the proposed chapters of the agreement, based on both on the texts of their own FTAs and their ambitions for improvement. The United States can be assumed to have put forward proposals based on its well-known “template” for chapters on issues such as environment, labour, intellectual property. Negotiations aimed at reaching consensus around agreed text are proceeding on a chapter-by-chapter basis, and the end result will almost inevitably be a hybrid of the various proposals put forward. Progress is being made in discussions to develop TPP rules of origin. It appears that the negotiators expect to ultimately reach agreement on a common text for all chapters of the TPP.

Indications are that so far the parties are adhering to the principle of being open to negotiation on all issues. No participant has yet taken an issue “off the table”, and the participants are maintaining the stance of requiring prospective new participants to accept that all issues must be “on the table” for negotiation.

The structure of the market access commitments that will emerge from the negotiations is still unclear at this stage. The United States has stated publicly that it does not intend to re-open market access arrangements with its existing bilateral partners although it is having informal discussions with them on market access issues. It appears that other participants are likely to negotiate bilaterally with the United States. At the same time most other participants are understood to have made plurilateral market access offers on goods applicable to partners other than the United States. It remains to be seen how far it will be possible to consolidate the bilateral commitments into a common schedule of commitments. It may be that in the end the schedules of market access on goods will be a mixture of common and bilateral elements, as is the case in agreements such as the ASEAN-

Australia-New Zealand FTA (AANZFTA) and the US-DR-CAFTA agreement. Acceptance of a mixture of common and bilateral commitments would ease the way for some exclusions, and the US position of not re-opening existing bilateral market access arrangements would also appear to be inconsistent with a “no exclusions” approach, since exclusions exist in at least some of those bilateral agreements. Agreement that TPP services market access offers will be made on a negative list basis also applies acceptance of some exclusions. The parties are a long way from declaring final positions, and it remains to be seen what the outcome will be in practice. There is still scope to explore alternatives to exclusions from goods commitments, such as longer time periods for phasing out tariffs, special safeguards, transitional tariff rate quotas, and other mechanisms to facilitate adjustment.

There has been no further increase in the number of participating economies. Japan’s decision on TPP participation remains pending. In the opening weeks of 2011, the issue of Japanese participation in the TPP became one of the most hotly debated topics in Japanese politics, as supporters of greater Japanese integration with the regional and global economies clashed head-on with defenders of the status quo, especially from the traditional agricultural interests. The picture was complicated by the weakness of Prime Minister Kan’s DPJ government, and the prospect that its possible imminent collapse would preclude a decision to proceed with TPP participation. In March 2011 the debate was overtaken by the devastating Great East Japan Earthquake and tsunami that hit Japan, and the subsequent crisis at the Fukushima nuclear power plant. Faced with the enormous task of recovering from these disasters the Japanese government understandably announced that the decision on TPP participation would be deferred. The subsequent replacement of Mr. Kan by Mr. Noda as Prime Minister of Japan means that some re-assessment of Japan’s position on the TPP is bound to occur and this will take time. The APEC Economic Leaders meeting in November looms as the next likely forum for Japan’s announcement of its decision on the TPP. The deferral of Japan’s decision on participation may also be encouraging other economies to adopt a ‘wait and see’ attitude.

The issue of Chinese participation in the TPP continues to revolve around the China-United States economic relationship and remains something of a dilemma. While it is

clear that TPP developments continue to be closely watched in China, there are also signs of increasing signs of frustration in the commentaries of leading Chinese academics who cite the lack of access for potential participants like China to information on progress in the TPP negotiations as support for their contention that China is effectively being excluded from the TPP, and seem increasingly inclined to label the TPP as part of a United States strategy to “contain” China. (Cai 2011) In contrast to its attitude toward Japanese participation the United States has shown no sign of encouraging China’s participation, which does nothing to dispel perceptions that the United States has a tacit preference for deferring the issue of China’s participation until after the TPP negotiations have been concluded. At the same time representatives of some other TPP participants have made public statements strongly opposing any use of the TPP as a strategic weapon against China, and there is little doubt that other participants continue to regard China’s participation as essential to fulfillment of the TPP’s intended role as a stepping stone towards the FTAAP, and remain anxious to communicate this message to China. It is however an unfortunate reality that the entry of China into the negotiations as a full participant would greatly complicate the politics of the TPP in the United States. Furthermore the rhetoric likely to be manifested on the campaign trail during the United States presidential election year is also not likely to be conducive to constructive approaches to the issue of Chinese participation in the TPP.

Indeed, when the US presidential election year is factored in along with the scheduled change in China’s top leadership also in 2012, and the ongoing weakness of political leadership in Japan, it is easy to imagine that relatively little progress may be made during 2012 on widening participation in the TPP, leaving substantive progress in 2013 as a best-case scenario. The likely intensification of “toxic politics” during the United States presidential election year could also slow the progress of the TPP negotiations in moving from an agreed outline to a completed agreement.

One question that might be considered by APEC is the extent of disclosure of details of the TPP negotiations to other APEC members. While TPP participants are regularly reporting progress in the negotiations to APEC senior officials (Lim 2011), it is clear that China and perhaps other potential participants among APEC members believe that there should be

fuller disclosure, perhaps even to the point of releasing draft texts, for the benefit of APEC non-participants (Cai 2011). This belief derives from the extent to which the TPP is embedded in the APEC agenda as a springboard for the FTAAP, and the clear intention that the TPP should be open to accession by other APEC members, resulting in the peculiar feature of the TPP negotiations that all APEC economies can be argued to have an interest in the negotiations, whether or not they are participating at present.

In the meantime there have been interesting developments in relation to the East Asian economic integration initiatives that can be interpreted at least in part as a response to the competitive dynamic in regional economic integration established by the APEC leader’s declaration on the subject in November 2011. In something of a surprise move China and Japan recently came together to make a proposal to ASEAN for commencement in 2012 of negotiations for a region-wide “ASEAN Plus” trade agreement, leaving open the issue of whether the “plus” should involve three, six or some other number of partners. China and Japan apparently asked ASEAN for a response to this proposal in time for the East Asian Summit and APEC leaders’ meetings in November. At the recent ASEAN Plus Six meeting in Manado, Indonesia, ASEAN noted the proposal from China and Japan, but countered with their own proposal to develop a “template” drawn from the provisions of the existing “ASEAN Plus” agreements, and to invite participation in a region-wide agreement based on this “template” by any countries willing to accept the “template”, again with no presumption as to the eventual number or identity of partners. This concept has been described as “ASEAN Plus Plus” or “ASEAN Plus n”. It remains to be seen whether the template will be based on the lowest common denominator among the current “ASEAN Plus” agreements, the ASEAN-India FTA, or on the most ambitious of these agreements, perhaps the AANZFTA. The outcome of this development will be an interesting test of ASEAN’s capacity to provide ongoing leadership in the East Asian economic integration processes, and also of its willingness to move away from its preferred “ASEAN Plus One” configurations to actively support the consolidation of most if not all of the “ASEAN Plus One” agreements into a single “ASEAN Plus” agreement. In particular it remains to be seen whether ASEAN will be able to propose a template that will be acceptable to the three major Northeast Asian economies as the basis for a region-wide

agreement that will include integration among themselves within its scope.

There are also unconfirmed reports that a decision in principle has been made to commence negotiations for a CJK (China-Japan-Korea) FTA in 2012, and that China and Korea have separately decided to commence negotiations in 2012 for a bilateral China-Korea FTA.

## 6. Conclusion

Simultaneous negotiation of a CJK FTA, a China-Korea FTA and a region-wide "ASEAN Plus" FTA will be a formidable challenge for the governments involved. If these foreshadowed negotiations do in fact materialize however, the pressure within the "competitive dynamics" of Asia-Pacific regional economic integration may swing across to the TPP. If this happens it will occur at a time when the signs are that progress in the TPP, both toward conclusion of an agreement among the existing participants and toward expanding participation in the TPP, may slow down at least temporarily. With these possibilities in play, 2012 promises to be an interesting year in the evolution of the Asia-Pacific regional trade architecture.

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