Trans-Pacific Partnership: A “21st Century” Trade Agreement

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Executive Summary

- On 5 October 2015, 12 Pacific-rim nations including the US and Japan announced successful conclusion of the Trans-Pacific Partnership (TPP) deal.

- The TPP agreement covers commitments on trade in goods, trade in services, investment and other policy areas that extend well beyond trade and economy, such as intellectual property protection, competition policy, operations of state-owned enterprises (SOEs), labor law and conditions, environmental protection, e-commerce facilitation, rules on telecommunications and development with regional integration. It sets a high standard for participating countries to comply with.

- In terms of trade in goods, the TPP members commit to eliminating most of the tariffs on industrial goods and progressively on agricultural products among the member countries. One caveat is that the TPP has a strict set of rules of origin. Preferential tariffs may induce companies to relocate production facilities to the TPP member countries, as well as switch to raw materials and intermediate inputs originated in the TPP.

- In particular, the textile and garment industry stands to benefit greatly from the TPP. Most tariffs on textile and apparel products among the member countries will be eliminated immediately once the TPP agreement comes into effect, with exceptions on sensitive products. In addition, the “yarn-forward” rule may cause manufacturers to switch to using materials originating from within the TPP region, bringing a windfall to the US textile industry initially, until the low-cost TPP countries catch up on technological capacity to produce fabrics.

- Business should carefully consider sourcing opportunities brought about by the TPP, while keeping in mind the caveats, such as rules of origin and stricter labor standards under the TPP. In addition, business shall stay on top of the development of the TPP – further announcement of details on the TPP agreement, progress of ratification as well as the development of other free trade agreements that involve TPP members.
I. Latest Developments

After more than five years of intense negotiations, 12 Pacific-rim nations including the US and Japan announced successful conclusion of the Trans-Pacific Partnership (TPP) deal on 5 October 2015. With its members making up nearly 40% of the world economy, it is the biggest and deepest trade pact since the NAFTA.

A summary of the text of the agreement has been published on 5 October 2015 but the full text has yet to be revealed. Negotiators will continue work on technical issues for preparing a final text for public release. While there is no explicit time frame for this process, some insiders expect that this would be completed in a month. ¹

Next, the TPP has to be ratified by each member country and be transposed into national laws before it can take effect. As the TPP is met with opposition in some member countries, the ratification process may be dragged on for months or even years. In particular, as the TPP is one of the hot-button issues in the 2016 US presidential campaign, US lawmakers are cautious about the TPP. In Chile, concerns over the TPP’s impact on access to medicine may be a hurdle. In Japan and New Zealand, the secrecy of the negotiations has led to legal complaints against the government. On the other hand, ratification is expected to be easy in Singapore, Vietnam and Brunei, thanks to positive public sentiment towards international trade as well as the nature of their political systems. ᵃ²


II. Overview of the TPP

What is the Trans-Pacific Partnership?

The Trans-Pacific Partnership (TPP) is a regional trade agreement that comprises 12 countries in the Pacific-rim region that proclaims to be a high quality, comprehensive “21st Century Trade Agreement”. TPP covers a wide range of issues that extend well beyond international trade and may impact the existing momentum in global value chains, hence sourcing, manufacturing and retailing in the Asia-Pacific region. Initially proposed by Brunei, Chile, New Zealand and Singapore in 2005, the influence of the TPP rocketed when the US joined in 2008. Currently, the 12 member states include Australia, Canada, Japan, Malaysia, Mexico, Peru, the US, Vietnam, Chile, Brunei, Singapore, and New Zealand. Together, TPP members accounted for nearly 36% of world GDP, 11% of world population and 26% of global trade in goods flow in 2014.  

Source: Fung Business Intelligence Centre

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The aim of the TPP is to set a standard for international free trade agreements and shape the framework of global trade regime in the new era. President Obama of the US claims, “with the TPP, we can rewrite the rules of trade to benefit America’s middle class. Because if we don’t, competitors who don’t share our values, like China, will step in to fill that void.” The TPP has five main features (US Trade Representative Office, 2015):

- **Comprehensive market access.** The TPP eliminates or reduces tariff and non-tariff barriers across substantially all trade in goods and services and covers the full spectrum of trade, including goods and services trade and investment, so as to create new opportunities and benefits for the businesses, workers, and consumers. As the tariff schedule has yet to be published, it remains to be seen whether tariff will be immediately reduced or phased out over a longer period.

- **Regional approach to commitments.** The TPP facilitates the development of production and supply chains, and seamless trade, enhancing efficiency and supporting the goal of creating and supporting jobs, raising living standards, enhancing conservation efforts, and facilitating cross-border integration, as well as opening domestic markets.

- **Addressing new trade challenges.** The TPP promotes innovation, productivity, and competitiveness by addressing new issues, including the development of the digital economy, and the role of state-owned enterprises in the global economy.

- **Inclusive trade.** The TPP includes new elements that seek to ensure that economies at all levels of development and businesses of all sizes can benefit from trade. It includes commitments to help small- and medium-sized businesses understand the Agreement, take advantage of its opportunities, and bring their unique challenges to the attention of the TPP governments. It also includes specific commitments on development and trade capacity building, to ensure that all Parties are able to meet the commitments in the Agreement and take full advantage of its benefits.

- **Platform for regional integration.** The TPP is intended as a platform for regional economic integration and designed to include additional economies across the Asia-Pacific region.
The TPP is set to expand in the future. Six more economies – Columbia, the Philippines, Thailand, Indonesia, Taiwan and South Korea – have expressed the intention to join.

Scope of the TPP

The TPP is the most extensive regional trade agreement up-to-date. With 30 chapters, the TPP covers trade in goods, trade in services and other important areas that may impact economy, society as whole and government administrations. (These are generally known as “behind the border” commitments because they set rules on the TPP Parties’ own regime.) Key commitments can be found in Tables 1 and 2.

TPP versus WTO

All current members of the TPP are also members of the WTO. The TPP, which grants more favorable conditions to its member countries than to other WTO member, departs from the WTO’s non-discrimination principle. However, the WTO permits such trade agreements subject to specific rules as well as transparency mechanisms.

The TPP is expected to achieve wider and deeper liberalization than the WTO. It spans various policy areas not covered in WTO agreements (such as competition policy, investment, movement of capital, environmental laws and labor market regulations). In the areas covered by the WTO (such as industrial and agricultural tariffs, technical barriers, service trade liberalization and intellectual property) the TPP promises deeper integration in areas covered by the WTO. In particular, services commitments in TPP far exceed commitments in the General Agreement on Trade in Services (GATS).

The TPP, by making significant progress in deep trade integration, may serve as a building block towards the multilateral trading system led by the WTO. On the other hand, it may also become a stumbling block for free trade if it heightens discrimination against non-TPP-members. As such, the future of multilateralism is highly contingent upon future dynamics between members and non-members of the TPP.

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4 WTO rules governing preferential trade agreements include (i) Paragraphs 4 to 10 of Article XXIV of governing the formation and operation of customs unions and free-trade areas covering trade in goods; (ii) the Enabling Clause permitting preferential trade arrangements in trade in goods between developing country Members; and (iii) Article V of GATS governing RTAs in trade in services.
III. Implications

All in all, the TPP could potentially transform the global value chains and existing set-up of trade in Asia-Pacific region. The 12 member countries form a mega-region without tariffs on most of the goods, which influence the competitiveness of other parties not in the TPP. Manufacturing activities, especially tariff heavy commodities may divert to TPP member countries.

Among the TPP member countries, Vietnam and Japan are likely to experience the biggest impact. In fact, most of the other member countries already have existing bilateral and regional trade agreements covering a large proportion of their trade with each other. Japan, which has been conservative on trade deals due to its protectionist policy toward domestic agriculture, and Vietnam, which is still transitioning to capitalism, have so far been relatively behind in trade liberalization. The TPP is expected to boost trade significantly in these two countries.

In terms of sectors, textiles and garments and agriculture are set to benefit the most because of the existing high trade barriers in these sectors. Tariffs on textiles and garments traded among TPP member countries will be eliminated. Quotas on agricultural products among member countries will be relaxed.

The media has widely reported, albeit largely based on speculation, on the likely winners and losers, both in terms of countries and industries, with respect to the TPP deal. A summary of BBC’s analysis is in Table 3.

Implications on the textile and garment sector

US apparel companies already source from five TPP member countries: Vietnam, Peru, Mexico, Malaysia, and the US itself. The TPP may further divert garment sourcing from non-TPP countries, such as China, to these member countries.

In addition, the “yarn forward” rule of origin may cause manufacturers to switch to using materials originated in TPP countries. The US textile industry may receive a windfall initially, as garment manufacturers in partner countries shift to US materials in order to fulfill the rule. In the longer term, however, companies may increase capital and technological investments to enhance the capacity to produce materials in textile-producing countries, such as Vietnam and Mexico.

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Implications on Sourcing from Vietnam and Malaysia

The TPP offers great opportunities for export-oriented member countries. As major manufacturing centers, Vietnam and Malaysia stand to benefit significantly.

Reduced tariffs in the US and Japan will benefit Vietnam’s garment and textile manufacturers, whose low labor costs and established garment industry have given it a competitive edge. In addition, Vietnam’s textile and garment sector already has well-established trade links with TPP countries, with TPP countries currently accounting for 70% of its exports. As garment and textile sector is viewed as one of the industries which will benefit the most from TPP, Vietnam is likely to see an influx of FDI in the sector as businesses set up new production facilities or expand their existing ones in the country.

Companies have already started building material production facilities in an effort to meet the “yarn-forward” rule. For example, Vinatex, Vietnam’s largest textile company, announced plans to invest more than US$714 million in dyeing and materials production facilities in Vietnam. South Korea’s Dong-IL Corp. is also building a US$52 million yarn factory in southern Vietnam, while Taiwan’s Forever Glorious has announced plans for a US$50 million weaving-dyeing-garment factory. Several Chinese textile companies, such as Esquel Group and Jiangsu Yulun Textile Group, have either opened or are in the process of building large textile plants in Vietnam. 8

As an export-oriented economy, Malaysia’s electronics, chemical products, palm oil and rubber exporters are among beneficiaries from tariff benefits provided by TPP. The deal would give Malaysia greater access to markets such as the US, Canada, Mexico and Peru, with which it does not currently have bilateral free-trade agreements.

On the other hand, the minimum standards for workers and the environment required by the TPP are likely to take a hit on the middle-income member countries such as Malaysia, Mexico, Peru and Vietnam. Labor conditions need to be dramatically improved in order to comply with the standards set forth by TPP, increasing labor cost and possibly disrupting production temporarily while factories adjust to the new rules.

Rules prohibiting countries from favoring SOEs are likely to speed up economic restructuring in state-capitalist countries like Malaysia and Vietnam, reducing the dominance of SOEs in their economies. 9

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Implications on China

Left out of the TPP, China is generally expected as one of the biggest losers in this development. The provision in the TPP, especially the “behind the border” rules, may be well ahead of the current stage of economic development in China. Since the 12 TPP member countries form a mega tariff free region which excludes China, Chinese exports to the TPP countries may be subject to higher tariffs and hence higher cost than from competing TPP member countries. Experts of various research institutions estimate a drop in Chinese exports from 0.5% to 1.2% with the TPP when compared to without the TPP. In particular, textile and apparel and electronics may be most heavily impacted industries in China. Trade diversion may also imply a slowdown of Chinese economic growth rate by 0.2 percentage point, according to a research center in the Ministry of Commerce, China.

On the other hand, China has already signed free trade agreements with 8 of the 12 TPP members respectively, which may help alleviate the impact of TPP. (Table 4) For a more accurate prediction of trade diversion effect, one has to await the publication of the full text of the TPP agreement.

The strict rules of origin set forth by the TPP may cause major shifts in value chain locations within Asia. In addition to production location, raw material sourcing and export of parts and components from China to the US and Japan may also be partially replaced by TPP member countries.

The TPP is perceived by some experts as a competitor to the Belt and Road Initiative of China. This might be true to some extent that the TPP involves countries on the Belt and Road such as Vietnam, Malaysia and Singapore. However, considering the broad horizon of the Belt and Road Initiative, which involves more than 60 countries, as well as the difference in the nature of the TPP and the Belt and Road Initiative, the impacts of the TPP on the Belt and Road Initiative may not be enormous.

China, on the other hand, has been actively preparing herself in the new era of FTAs. Most notably, the Regional Comprehensive Economic Partnership (RCEP), which is heavily influenced by China, is now under negotiation. RCEP covers ASEAN and 6 other countries (Table 5), which may help China to expand her FTA network and enhance her economic influence in the Asia Pacific Region.
### Table 1 | TPP Commitments on Trade in Goods & Services and Investment

<table>
<thead>
<tr>
<th>Category</th>
<th>Chapter</th>
<th>Key Policies</th>
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</table>
| **Trade in Goods**| Overall     | • Cut tariffs in most of manufactured goods immediately  
• Cut tariffs progressively in selected categories of goods, such as agricultural products |
|                   | Textile and Apparel | • Eliminate tariffs, mostly immediately with some special exception for sensitive goods, which are subject to a longer phase-out period  
• Require use of yarns and fabrics from TPP countries to enjoy preferential treatment for textile and apparel  
• “Short-supply list” mechanism to allow use of certain yarns and fabrics not widely available within the TPP region |
|                   | Rules of Origin | • Single set of rules of origin for all 12 member countries  
• Inputs from one TPP Party are treated the same as materials from any other TPP Party  
• Include product-specific rules of origin (PSRs) that are based on the “tariff-shift” approach, which clearly sets out the non-originating materials that may be used in production |
|                   | Other chapters | • Customs Facilitation – improve transparency of customs procedures  
• Sanitary and Phytosanitary (SPS) Measures – import programmes based on risk associated with importation and inspections without delay  
• Technical Barriers to Trade (TBT) – transparent, non-discriminatory rules for developing technical regulations, standard and conformity procedures with public participation; Foster mutual acceptance of conformity |
<table>
<thead>
<tr>
<th>Category</th>
<th>Chapter</th>
<th>Key Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade in Services</td>
<td>Overall</td>
<td>• Include core obligations found in WTO and other FTAs – Most Favored Nations (MFN), national treatment, market access</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No quantitative limitation on supply of services, requirement on specific type of legal entity or joint venture and requirement on local presence</td>
</tr>
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<td></td>
<td>• “Negative-list” approach to commitment – except sectors taken in exception, all other sectors are open to all TPP Party</td>
</tr>
<tr>
<td></td>
<td>Overall</td>
<td>• Include core obligations found in WTO and other FTAs – Most Favored Nations (MFN), national treatment, market access</td>
</tr>
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<td></td>
<td></td>
<td>• Supplier from a TPP country can provide financial services in other TPP countries if domestic companies in that market are allowed to do so</td>
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<tr>
<td></td>
<td></td>
<td>• Specific commitment on insurance, portfolio management, electronic card services and transfer of information</td>
</tr>
<tr>
<td>Financial Services</td>
<td></td>
<td>• Include core obligations found in WTO and other FTAs – Most Favored Nations (MFN), national treatment, market access</td>
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<td></td>
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<td>• Supplier from a TPP country can provide financial services in other TPP countries if domestic companies in that market are allowed to do so</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Specific commitment on insurance, portfolio management, electronic card services and transfer of information</td>
</tr>
<tr>
<td>Telecommunications</td>
<td></td>
<td>• Ensure efficient and reliable telecommunication networks available</td>
</tr>
<tr>
<td>E-Commerce</td>
<td></td>
<td>• Ensure free flow of global information and data that drives Internet and digital economy, subject to legitimate public policy objectives such as personal information protection</td>
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<tr>
<td></td>
<td></td>
<td>• No customs duties on electronic transmission</td>
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<td>• Not to require TPP companies build data centres to store data as a condition for operating in TPP market. Source code is not required to transfer or accessed</td>
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<td>• No favoring of national producers or suppliers through discriminatory measures or outright blocking</td>
</tr>
<tr>
<td>Category</td>
<td>Chapter</td>
<td>Key Policies</td>
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</table>
| Investment | Overall | • Include core obligations found in WTO and other FTAs – Most Favored Nations (MFN), national treatment, “minimum standard of treatment” for investment according to international law principles  
• Prohibition on “performance requirement” such as local content or technology localization requirements  
• Free transfer of fund on investment (no capital controls) unless in balance of payment crises, economic crises or to protect integrity and stability of financial system  
• No nationality requirement on senior management positions  
• Provide access to an independent international investor-state dispute settlement (ISDS) mechanism that is prompt, fair and transparent, and subject to appropriate safeguards.  
• “Negative-list” approach to investment for TPP Parties |

Source: U.S. Trade Representatives Offices; Foreign Affairs, Trade and Development Canada, Canada Government; Department of Foreign Affairs and Trade, Australia; Ministry of Foreign Affairs and Trade, New Zealand; Compiled by Fung Business Intelligence Centre
## Table 2 | Other Areas of Commitment in TPP

<table>
<thead>
<tr>
<th>Category</th>
<th>Chapter</th>
<th>Key Policies</th>
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| Other Policies| Temporary Labor Movement         | • Commitments on access for each other’s business person  
• Open and transparent policy for visa                                                                                                                                         |
|               | Government Procurement           | • National treatment and non-discriminatory to other parties of the TPP  
• Fair and transparent government procurement procedures                                                                                                                      |
|               | Competition Policy               | • The TPP Parties agrees to adopt and maintain national competition law that proscribe anticompetitive business conduct and apply to all commercial activities in their territories |
|               | SOEs                             | • A framework of rules on SOEs among all the TPP Parties  
• SOEs run on commercial considerations  
• No discriminations against the enterprises, goods and services of other Parties                                                                                       |
|               | Intellectual Properties          | • Commitment to protect and enforce copyrights and related rights  
• Ensure patents protection for inventions in all fields of technology and promotes transparencies  
• Commitment to provide strong enforcement systems  
• Pharmaceutical-related provisions that facilitate the development of innovation                                                                                         |
|               | Labor                            | • Allow freedom of association and recognize the right to collective bargaining in the Parties  
• Commitment to elimination of forced labor, child labor and discriminations on employment  
• Have local laws governing minimum wages, hours of work and occupational safety and health                                                                           |
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<tr>
<th>Category</th>
<th>Chapter</th>
<th>Key Policies</th>
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| Environment | • Commitment to work together to address environmental challenges, including pollution, illegal wildlife trafficking, illegal logging, illegal fishing and protection of marine environment  
• Commitment not to weaken environmental law in order to encourage trade and investment  
• Commitment to enforce environmental laws | |
| SMEs | • Commitment to provide easily accessible information for SMEs and promote the benefit to SMEs | |
| Other chapters | • Encourage development by regional integration  
• Foster regulatory coherence  
• Promote transparency in government administration and anti-corruption  
• Dispute Settlement mechanism among Parties to resolve conflicts | |

Source: U.S. Trade Representatives Offices; Foreign Affairs, Trade and Development Canada, Canada Government; Department of Foreign Affairs and Trade, Australia; Ministry of Foreign Affairs and Trade, New Zealand; Compiled by Fung Business Intelligence Centre
Table 3 | BBC’s Prediction on the Likely Winners and Losers

<table>
<thead>
<tr>
<th>Sector</th>
<th>Impact</th>
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<tbody>
<tr>
<td>Carmakers</td>
<td>• Some of the <strong>world's biggest car firms based in Japan</strong>, such as Toyota and Honda, would <strong>benefit</strong> from getting cheaper access to the US, which is its biggest export market</td>
</tr>
<tr>
<td></td>
<td>• Japanese carmakers may be able to manufacture US-bound cars with parts bought from elsewhere in Asia, as the deal enforces minimums for locally sourced materials</td>
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<tr>
<td></td>
<td>• Meanwhile, <strong>US vehicle exports would also grow</strong> if car tariffs as high as 70% in growing emerging markets such as Vietnam are removed</td>
</tr>
<tr>
<td>Farmers</td>
<td>• <strong>Farmers and companies behind foods such as US poultry</strong>, that are currently taxed up to 40% in some cases, <strong>will benefit if those taxes are cut or eliminated</strong></td>
</tr>
<tr>
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<td>• US soybeans, for example, can be taxed as much as 35%</td>
</tr>
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<td>• <strong>Beef farmers are also set to gain on the reduction or elimination of tariffs</strong> on the meat into Japan, Mexico and Canada over 10 years</td>
</tr>
<tr>
<td></td>
<td>• Other foods that would see 98% of the taxes eliminated include dairy, sugar, wine, rice and seafood</td>
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<tr>
<td></td>
<td>• <strong>Big food exporting countries such as Australia and New Zealand will benefit</strong> from the move</td>
</tr>
<tr>
<td>Local job markets</td>
<td>• Several labour groups are worried the deal would result in <strong>jobs leaving developed economies</strong> such as the US and being sent to countries with lower wages and less strict labour laws</td>
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<tr>
<td></td>
<td>• The deal would intensify competition between countries' workforces</td>
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<td>• <strong>Vietnam is considered among the big winners</strong>, as analysts predict the deal would boost its growth by 11% in the next 10 years as firms move factories to the low-wage country</td>
</tr>
<tr>
<td></td>
<td>• But for <strong>less developed economies</strong>, it will also mean they have to <strong>abide by international labour laws</strong>, such as introducing a minimum wage</td>
</tr>
</tbody>
</table>
### Sector | Impact
---|---
**Drugmakers** | - The deal gives pharmaceutical companies up to eight years of protection for new biotech drugs (expensive medicines produced in living cells), rather than 12 years of protection pushed by the US
- **Activists argue that blocking rivals from making copies of the drugs will drive up the prices of prescription drugs** and make them more expensive for people in poorer countries
- It could also **strain national healthcare budgets** and **keep life-saving medicines from patients** who cannot afford them

**Tech firms** | - **Tech giants** such as Google and Uber will **see restrictions removed on sales in foreign markets**, along with requirements that they establish local infrastructure
- The countries also vowed to lower global roaming charges through regulation, which could **result in increasing competition among telecoms giants**

Table 4 | FTAs signed between China and TPP members

FTAs between TPP members and China as of Oct 7, 2015

Source: Fung Business Intelligence Centre
Table 5 | FTAs signed between China and RCEP members

FTAs between other RCEP members As of Oct. 12, 2015

Source: Fung Business Intelligence Centre
The Fung Group is a privately held multinational group of companies headquartered in Hong Kong whose core businesses are trading, logistics, distribution and retailing. The Fung Group employs 46,800 people across 40 economies worldwide, generating total revenue of more than US$24.65 billion in 2014. Fung Holdings (1937) Limited, a privately held business entity headquartered in Hong Kong, is the major shareholder of the Fung group of companies.

The Fung Business Intelligence Centre collects and analyses market data on sourcing, supply chains, distribution and retail. It also provides thought leadership on technology and other key issues shaping their future.

Headquartered in Hong Kong, FBIC leverages unique relationships and information networks to track and report on trends and developments in China and other Asian countries. In addition, its New York-based Global Retail & Technology research team follows broader retail and technology trends, specialising in how they intersect and building collaborative knowledge communities around the revolution occurring worldwide at the retail interface.

Since its establishment in 2000, the FBIC (formerly known as the Li & Fung Research Centre) has served as the knowledge bank and think tank for the Fung Group. Through regular research reports and other publications, it makes its market data, impartial analysis and expertise available to businesses, scholars and governments around the world. It also provides advice and consultancy services to colleagues and business partners of the Fung Group on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.