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**Getting from Here to There: Stitching Together Goods Agreements  
in the Trans-Pacific Partnership (TPP) Agreement**

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## Abstract

The Trans-Pacific Partnership (TPP) talks are a good test case for examining what happens when sweeping, grand rhetoric meets political and economic realities. In these ongoing negotiations, officials began the talks in late 2009 and early 2010 with repeated pronouncements about the need to open markets “with no exceptions” to the other members. These statements applied particularly to trade in goods. This paper examines the extent to which negotiators were able to meet these aspirational goals after 11 rounds of meetings in two years. Although the Americans were most vocal in their insistence on the high quality nature of the proposed agreement in goods trade, it has been the demands of the United States that have most limited the liberalization actually present in the draft agreement. The lack of market access has been compounded by the approaches used by the Americans to negotiate over market opening in goods. The Trans-Pacific Partnership agreement might yet end up being a high-quality, 21<sup>st</sup> century agreement, but market access in goods will *not* be at the cutting edge, but rather, bringing up the rear.

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# **Getting from Here to There: Stitching Together Goods Agreements in the Trans-Pacific Partnership (TPP) Agreement**

## **Introduction**

The Trans-Pacific Partnership (TPP) talks are a good test case for examining what happens when sweeping, grand rhetoric meets political and economic realities. In these ongoing negotiations, officials began the talks in late 2009 and early 2010 with repeated pronouncements about the need to open markets with “no exceptions” to the other members. These statements applied particularly to trade in goods. This paper examines the extent to which negotiators were able to meet these aspirational goals after 11 rounds of meetings in two years. Although the Americans were most vocal in their insistence on the high quality nature of the proposed agreement in goods trade, it has been the demands of the United States that have most limited the liberalization actually present in the draft agreement. The lack of new market access has been compounded by the negotiating approaches used by the Americans over market opening in goods. The agreement is not finished, of course, so there is still the possibility of a breakthrough in the talks. However, after two years of negotiations in goods, the prospect for an agreement that matches the rhetoric of “no exceptions” does not look bright.<sup>1</sup>

## **Launching the Trans-Pacific Partnership (TPP) Negotiations**

The birth of the TPP could be traced to September 2008. It was then that Susan Schwab, United States Trade Representative, announced the intention of the

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<sup>1</sup> For a broader review of the TPP agreement, see the forthcoming book, *Trans-Pacific Partnership: The Quest for a 21<sup>st</sup> Century Trade Agreement*, C.L. Lim, Deborah Elms, and Patrick Low (eds.) (Cambridge University Press, August 2012).

United States to join an existing agreement, the Trans-Pacific Strategic Economic Partnership Agreement (TPSEP), more commonly known as the “P4.” The press release read, “This high-standard regional agreement will enhance the competitiveness of the countries that are part of it and help promote and facilitate trade and investment among them, increasing their economic growth and development.”<sup>2</sup>

There was a recognition that moving ahead in the final days of the George W. Bush Administration was problematic. However, Schwab added afterwards in a statement in 2009 that the largely non-partisan USTR staff had accepted that any incoming administration would want to be involved in these talks.<sup>3</sup> Her objective was to start the process moving without unduly hampering the room for maneuver for the next batch of officials.

The P4 agreement was a small preferential trade agreement (PTA) between Brunei, Chile, New Zealand and Singapore.<sup>4</sup> It had come into force with little fanfare in 2006. This was primarily because these four countries have very little trade between them. The two countries that do trade with one another—New Zealand and Singapore—already had an existing bilateral agreement (NZSCEP) and another regional agreement, the ASEAN-Australia-New Zealand (AANZFTA) Free Trade Agreement, in place. Instead, the P4 was largely a symbolic agreement intended to demonstrate to other members of the Asia Pacific Economic Cooperation (APEC) that

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<sup>2</sup> United States Trade Representative Statement, Press Release, September 2008.

<sup>3</sup> Schwab said at a meeting in Singapore on November 10, 2009.

<sup>4</sup> For more on the P4 agreement, see Henry Gao, “The Trans-Pacific Strategic Economic Partnership Agreement: High Standard or Missed Opportunity?” and Ann Capling, “Multilateralising PTAs in the Asia-Pacific Region: A Comparison of the ASEAN-Australia-NZ PTA and the P4 Agreement.” Both papers were presented at the ARTNeT conference, “Trade Led Growth in Times of Crisis,” Bangkok, Thailand, November 2, 2009.

it was possible to start with a small agreement and gradually add more members through an accession clause.

The accession clause in the P4 is a highly unusual feature in a PTA. As the document states, “The Agreement is open to any APEC economy or any other State (Article 20.6), subject to terms to be agreed among the Parties.” It was included primarily to encourage other APEC member countries to join in an eventual quest to become a Free Trade Area of the Asia-Pacific (FTAAP) among all 21-member economies.

After the American announcement of interest in 2008, the Australians quickly declared their own intention of joining the talks. They were rapidly followed by Peru. The P4 had become the P7 or the TPP. Vietnam asked to join the talks as an observer.

The original start date for talks was early 2009. Although Susan Schwab had tried to rope in the incoming Obama administration to the TPP, it took a full year before USTR was ready to begin negotiations. The first official round of talks did not take place until March 2010 in Melbourne. Once launched, negotiations moved quite quickly, with negotiation rounds scheduled as often as every other month across periods as long as two weeks as officials scrambled to complete negotiations as rapidly as possible. The original target date for completion of the talks was the November 2011 APEC Leader’s Meeting in Hawaii.<sup>5</sup>

The TPP continued to expand with the addition of Malaysia in the third round in October 2010. Vietnam moved from being an observer to the talks to a full member in November 2010. This brought the total number of states in the TPP to nine.

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<sup>5</sup> Although this deadline was not met, officials worked as though it would, in fact, be achieved all the way through the end of the Singapore round in June 2011. It was not until this meeting that they changed the target deadline to a softer objective of completing the “broad outlines” of an agreement in November 2011.

In November 2011, Japan, Canada and Mexico officially announced their intentions to join the grouping. However, at the start of 2012, it was not yet clear when—or even if—the TPP nine would allow these three new countries to join.<sup>6</sup> This paper therefore considers the negotiations in goods trade only among the current nine members.

### **Soaring Rhetoric, But Small Markets**

One of the distinguishing characteristics of the TPP from the earliest moments has been an emphasis on the “high quality, 21<sup>st</sup> century” nature of the agreement. Of course, no official has ever announced a plan to engage in negotiations for a “low quality, 20<sup>th</sup> century” agreement. However, the TPP stands out in the consistent use of the highest levels of aspirational language to describe the goals and objectives of the agreement from the beginning.

One of the clearest benchmarks set by officials from the earliest moments of negotiations has been the use of the term “no exceptions.”<sup>7</sup> This applies particularly to market access for goods. Trade in goods between TPP partners is meant to be completely liberalized to one another. This includes not just industrial goods, but also agricultural items as well.

Opening markets to one another in goods is important for two reasons. First, there is relatively limited trade between most of the member countries. The United States is—by far—the largest economy in the grouping. Within the TPP, American imports in 2010 from other TPP members reached USD\$81.7 billion and exports

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<sup>6</sup> The procedure for joining the TPP is that a new country needs to hold bilateral talks with each existing member and then the entire group needs to approve a new member by consensus. By the first official meeting in March 2012, additional countries were also making noises about joining the TPP in the future as well.

<sup>7</sup> Interviews with lead TPP negotiators, September 2009.



were USD\$89.2 billion.<sup>8</sup> Australia imported USD\$56 billion from other TPP members (including \$23 billion from the United States) and exported USD\$25 billion to other members.<sup>9</sup> Singapore imported USD\$77 billion and exported USD\$87 billion. Malaysia imported USD\$ 43 billion and exported USD\$58 billion. Contrast these figures with those of Chile, which only imported about USD\$12 billion (of which nearly \$10 billion was from the United States) and exported USD\$10 billion to TPP members. Vietnam's total merchandise trade (imports and exports) was USD\$35 billion; for Peru the total is USD\$16 billion and for Brunei the total is USD\$3 billion. Keep in mind that these figures all double count the extent of merchandise trade within the TPP, as they record both the export from country A and import to country B of the same item.

The second reason for pushing for broad liberalization of goods markets in the TPP is that most partners are already linked together by a dense web of overlapping preferential trade agreements, as shown in Table 1. This means that, particularly for market access in goods, most of the TPP members have already granted one another preferential access to each other's markets. Generally, this preferential access already takes place at tariff levels at or near zero. Even for countries that are not connected by bilateral agreements, most favoured nation (MFN) preference rates for most non-agricultural products are quite low. If the TPP aims to make a difference for trade in goods, it will require opening markets in areas where existing preferential deals have not yet gone.

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<sup>8</sup> Brock Williams, "Trans-Pacific Partnership Countries: Comparative Trade and Economic Analysis," Congressional Research Service, February 8, 2012, p.4-5.

<sup>9</sup> All figures from Williams, p. 32-33. See also his excellent chart, p. 22.

**Table 1: Overlapping PTAs in TPP Member States**

	Australia	Brunei	Chile	Malaysia	New Zealand	Peru	Singapore	United States	Vietnam
Australia		• AANZFTA (2010)	• ACiFTA (2009)	• AANZFTA (2010)	• ANZCERTA (1983) • AANZFTA (2010)		• SAFTA (2003) • AANZFTA (2010)	• AUSFTA (2005)	• AANZFTA (2010)
Brunei	• AANZFTA (2010)		• P4 (2006)	• AFTA (1982) • AANZFTA (2010)	• P4 (2006) • AANZFTA (2010)		• AFTA (1982) • P4 (2006)		• AFTA (1982) • AANZFTA (2010)
Chile	• ACiFTA (2009)	• P4 (2006)		• MCFTA (2012)	• P4 (2006)	• Peru-Chile (2009)	• P4 (2006)	• US Chile (2004)	
Malaysia	• AANZFTA (2010)	• AFTA (1982) • AANZFTA (2010)	• MCFTA (2012)		• MNZFTA (2010) • AANZFTA (2010)		• AFTA (1982) • AANZFTA (2010)		• AFTA (1982) • AANZFTA (2010)
New Zealand	• ANZCERTA (1983) • AANZFTA (2010)	• P4 (2006) • AANZFTA (2010)	• P4 (2006)	• MNZFTA (2010) • AANZFTA (2010)			• ANZSCEP (2001) • P4 (2006) • AANZFTA (2010)		• AANZFTA (2010)
Peru			Peru-Chile (2009)				• PeSFTA (2009)	• PTPA (2009)	
Singapore	• SAFTA (2003) • AANZFTA (2010)	• AFTA (1982) • P4 (2006)	• P4 (2006)	• AFTA (1982) • AANZFTA (2010)	• ANZSCEP (2001) • P4 (2006) • AANZFTA (2010)	• PeSFTA (2009)		• USSFTA (2004)	• AFTA (1982) • AANZFTA (2010)
United States	• AUSFTA (2005)		• US - Chile (2004)			• PTPA (2009)	• USSFTA (2004)		
Vietnam	• AANZFTA (2010)	• AFTA (1982) • AANZFTA (2010)		• AFTA (1982) • AANZFTA (2010)	• AANZFTA (2010)		• AFTA (1982) • AANZFTA (2010)		

- AANZFTA: ASEAN-Australia-New Zealand Free Trade Area, January 1, 2010
- ACiFTA: Australia Chile Free Trade Agreement, March 6, 2009
- AFTA: ASEAN Free Trade Agreement, January 28, 1992
- ANZCERTA: Australia New Zealand Closer Economic Relations Trade Agreement, January 1, 1983
- AUSFTA: Australia United States Free Trade Agreement, January 1, 2005
- MCFTA: Malaysia-Chile Free Trade Agreement, January 1, 2012
- MNZFTA: Malaysia-New Zealand Free Trade Agreement, August 1, 2010
- P4: Trans-Pacific Strategic Economic Partnership Agreement, May 28, 2006
- Peru Chile Free Trade Agreement, March 1, 2009
- PeSFTA: Peru Singapore Free Trade Agreement, August 1, 2009
- PTPA: United States Peru Trade Promotion Agreement, February 1, 2009
- SAFTA: Singapore Australia Free Trade Agreement, July 28, 2003
- United States-Chile Free Trade Agreement, January 1, 2004
- USSFTA: United States Singapore Free Trade Agreement, January 1, 2004

Note: Chart does not include ASEAN-China, ASEAN-India, ASEAN-South Korea or ASEAN-Japan which would connect ASEAN members Brunei, Malaysia, Singapore and Vietnam together again

There are four areas where the TPP could make a contribution to liberalizing trade in goods: by opening markets between those partners who do not yet have a bilateral deal between them; by opening markets in those limited areas in industrial or non-agricultural goods where trade liberalization has not yet occurred or has been limited; by opening markets in agriculture; and by untangling the so-called “noodle bowl” of preferential deals, particularly by sorting out the challenges posed by difficult rules of origin by using a simple, low threshold rule of origin in the TPP. Each of these areas is addressed in turn below.

Trade in goods is not just about reductions in tariffs or rules of origin, of course. Trade between partners can also improve with better trade facilitation and changes in customs procedures. There are also a host of other barriers to trade in goods including standards, regulations, labeling and so forth. Many of these other types of barriers to trade in goods are addressed in other areas of the TPP negotiations. This paper is focused only on the bargaining taking place in the chapters on market access for goods.

In the early days of the TPP negotiations, all market access for goods was being considered in one chapter only. This chapter would have encompassed both agricultural and non-agricultural goods as well as textiles and footwear. Keeping all these items in one chapter may have simplified the negotiations, as it would have made it more difficult to treat these kinds of goods differently. As noted in greater detail below, agricultural goods and textiles can be subject to quantitative restrictions that are not used in non-agricultural goods. Keeping them all together would have made this separate treatment harder to justify. However, this early plan at unity was abandoned and goods were instead broken into three separate chapters with an additional chapter on rules of origin.

## **Opening to Non-PTA Partners**

A glance at Table 1 reveals that most of the current nine TPP partners are well connected to one another. The two main exceptions are Peru and the United States. The United States has bilateral agreements in place with Australia, Chile, Peru and Singapore. American influence in the TPP, however, runs deeper than this list suggests. Partly as a result of these agreements and partly as a result of the disproportionate power the United States holds within the group, the very structure of the TPP is built largely along American templates.

This arrangement might have been expected to make negotiations, especially in goods, easier. For the countries in the TPP, trade in goods has already been discussed before. Officials have already dealt with their internal politics and have worked out the necessary compromises with internal ministries and departments required to open goods trade to new countries. Business has already formed coalitions to support trade liberalization. Industries that have been badly affected by trade opening have often largely been bought off in one form or another in past agreements. This does not, of course, mean that business and other branches of government will automatically support trade liberalization in the TPP, but it does mean that the battle lines are likely already drawn and the players know their respective roles at the domestic level.

The fact that many of the TPP countries have existing agreements also means that many of the specific issues in goods trade have already been discussed before. In some cases, the sensitive issues have been resolved. In others, they were not. For example, in the U.S.-Australia FTA, sugar was excluded from the final agreement. In the TPP, sugar is back on the agenda. The fact that sugar has been discussed in the past means that officials on both sides of the negotiations know very clearly where the

specific sensitivities in sugar lie without having to spend multiple rounds of negotiations mapping out the parameters of a possible solution.

Even for countries that do not have existing bilateral PTAs with one another, they have extensive experience negotiating over trade in goods. This makes it quite different from many other chapters in the TPP. For example, in services, both Malaysia and Vietnam have had to conduct negotiations on the basis of a negative list, which is a wholly new way of operating than previous commitments. In other areas like intellectual property rights, some of the TPP members are being asked to make commitments in areas that they have never addressed before. In places like regulatory coherence or supporting small and medium enterprises, all nine TPP members are “feeling their way” through new issues since no existing PTA has attempted to create rules to address these concerns. But in goods, all TPP partners have had decades of experience in negotiations.

One early issue set the tone for much of the rest of the negotiations. This was an important structural issue relating to the process of negotiations. Broadly speaking, there were three ways to approach the talks over market access in goods. In these talks, negotiators had to figure out how to exchange concessions (mostly cuts in tariffs and tariff peaks) with one another.<sup>10</sup>

This is much more complicated than it first appears. There are nearly 6,000 tariff lines corresponding to trade in goods. For the nine countries in TPP (except for Singapore which has tariffs at zero on all products except for 6 lines) the starting point varies tremendously. Some countries, like Malaysia, have higher across-the-

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<sup>10</sup> As we will see later, in some products, especially agricultural items and textiles, there are also some complex quantitative restrictions that had to be discussed and loosened for some countries.

board tariff levels, especially in agricultural goods.<sup>11</sup> Others maintain high tariff peaks, like the United States in textiles. Even if all the members agree that the end goal of the exercise is to get to zero tariffs at the end of the day, this implies different levels of commitment (and domestic pain and suffering) for different partners. If the goal is not to get all the way to zero tariffs, then the goal is to get tariffs lowered for partners as much as possible, and certainly to lower them off the starting MFN rates.

It is also not realistic to expect the developing country members to cut down tariffs—particularly to reach zero—on the same timelines as the most advanced developed country members for all products. This implies that at least some tariff reductions may be phased in at different rates for different members.<sup>12</sup>

In spite of these complications, the first method of sorting out tariff reductions and opening up trade in goods was to start from scratch on a multilateral basis among all nine member countries.<sup>13</sup> This would have involved working together to draw up one schedule that would have applied to all nine countries. Officials would have gone through the roughly 11,000 tariff lines, product by product or line by line, to determine what level of tariffs they were willing or able to accept as a collective group. They would also agree on the timelines for phasing in these cuts.<sup>14</sup> In other words, whatever concessions were made in the schedule by Country A on Product Z would

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<sup>11</sup> In general, developing countries have higher tariffs than developed countries. Vietnam, which joined the WTO in 2007, is an exception. As a recently acceded member, Vietnamese tariffs were bound at very low rates—often below developed country levels.

<sup>12</sup> Interviews with various TPP officials suggested that timelines will stretch to 10 years and not more than 15 years for a possible, very limited, set of sensitive products.

<sup>13</sup> Or start with all seven original members and then extend the talks to Malaysia after it joined and to Vietnam once it moved from observer to full membership.

<sup>14</sup> Under the terms of the TPP, developing country members are required to accept the same levels of commitment as developed country members. This means that Vietnam, for example, must accept either the same (or at least similar) tariff commitments as the United States or Australia—subject, of course, to negotiation. However, the timeline for these commitments may vary, giving Vietnam a longer timeframe to come into compliance.

have applied to all countries. There would have been one schedule at the end of the negotiations with tariff rates that applied to all nine members equally.

This approach would have been the cleanest and easiest for business to use at the end of the day. A manufacturer of plastic widgets could simply look up the tariff rates, for example, on the product in one TPP member country and it would be exactly the same (at some point in the future) for all TPP member countries. In the interim, however, the rates could change from year to year as tariff cuts were phased in, adding an additional layer of complication for business.

A second approach would have been to negotiate market access on a bilateral basis. This approach is basically how the General Agreement on Tariffs and Trade (GATT) handled market access in goods.<sup>15</sup> Although the GATT was a multilateral institution, in practice, each country prepared its own market access schedule as a result of complex negotiations with other countries.<sup>16</sup> At the end of the round of negotiations, each country had an individual schedule of tariff reductions that did not resemble the tariff cuts of any other country. Something similar could take place in the TPP. Officials could develop their own, specific, schedule for each country after engaging in bilateral negotiations with the other eight countries in the TPP. The final schedule for each member would represent the results of these bilateral negotiations

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<sup>15</sup> The World Trade Organization (WTO), successor to the GATT, has not completed a round of negotiations that includes tariff reductions. However, the Doha Development Agenda (DDA), attempted to lower tariffs using a new approach. Instead of “request-and-offer,” officials tried using a “formula cut” approach where a specific formula would apply across-the-board to groups of countries. Although the actual process was quite complex, to use a simple example, this method could have cut tariffs in multiple countries, say, 10 percent all at once without the need for individual negotiations.

<sup>16</sup> The final results, however, were given to all other members of the GATT as Most Favored Nation (MFN) concessions—so all GATT members received the same outcome (ie, I give a 5 percent tariff on paper cuts to all 8 other parties). Under my hypothetical bilateral option, however, the final TPP schedules would not be MFNed to everyone else—the final result would be a series of nine different bilateral market access schedules. Indeed, it could be possible to have an even more complex scenario under which all nine partners finish negotiations with bilateral schedules that apply only to each bilateral partner—in other words, 9 x 9 schedules.

all aggregated together into one set of commitments. The final TPP schedules would include the nine country-specific bilateral schedules (and not a single TPP-wide schedule like the first option). Any exporter of plastic widgets would need to examine the specific tariff schedules of a specific TPP member country to determine the tariff rates that would be applicable to the product.

The third approach was a hybrid between the two. Some elements could be negotiated multilaterally and others handled on a bilateral basis. In general, the sensitive products could be handled bilaterally and the less sensitive products and everything where tariffs are at zero could be addressed in a multilateral fashion. The end result would be a schedule in common across all nine members for some subset of the total number of goods and a country-specific set of schedules for the remaining goods. In other words, there would be ten different goods schedules under a hybrid system: one in common to all the countries and nine smaller schedules with specific country commitments. Our exporter of widgets would have to determine whether or not his or her widgets were part of the common schedule (one tariff applicable to all countries) or the bilateral commitments schedules (which might be similar across some, but not all, TPP members).

The difficulties of negotiating each of these three approaches, however, were compounded by the challenging issues of existing PTAs. By definition, PTAs are preferential agreements—they give specific preferences or benefits to some countries that are not given to others. These deals are the result of carefully crafted compromises at the time of negotiation in each agreement. Any decision on how to negotiate in the TPP would run the risk of upsetting existing PTA preferences. As an illustration, consider the treatment of sugar. It was excluded completely in the U.S.-



Australia FTA.<sup>17</sup> If sugar were included under any version of a TPP agreement, the American market would be opened to Australian sugar.<sup>18</sup> This would undercut the prohibition on greater Australian sugar access that was enshrined in the U.S.-Australian FTA.

This problem is worse when the parties negotiate multilaterally. A multilateral approach makes it most difficult to exclude or carve out existing deals. It is easiest to preserve existing agreements when negotiating bilaterally. This is particularly true for the United States, which has the added benefit of having sufficient negotiating muscle to largely get what it wants in bilateral settings against the mostly smaller and weaker states in the TPP setting.

The lead negotiators and heads of trade departments dealing with goods met formally three times between March and August 2010 in an attempt to deal with the vexing issue of how to negotiate in the context of existing PTAs. At the end of the third “inter-sessional” meeting in Peru, the group essentially decided not to decide.<sup>19</sup> Instead of agreeing to negotiate bilaterally or multilaterally, officials reached an interim “agreement” to avoid discussing it any longer. They agreed to “skip over” the issue and focus instead on offering specific market access deals to various members.<sup>20</sup>

In practice, this meant that the United States opted for the bilateral option. It tabled its first market access offers to Brunei, Malaysia, New Zealand, and Vietnam in mid-January 2011. These are the four countries with which it did not already have

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<sup>17</sup> It was excluded at the request of the United States in exchange for cutting out an investor-state dispute mechanism from the final agreement as the Australians demanded.

<sup>18</sup> Note that this would take place in practice, as exporters of sugar would use the provisions of the TPP agreement, rather than the provisions of the existing bilateral agreement to ship sugar into the U.S. market. The existing bilateral agreement would continue to exist—it would not be terminated.

<sup>19</sup> “TPP Countries Reach Initial ‘Deal’ on How to Handle Market Access Talks,” *Inside U.S. Trade*, Vol. 28, No. 37, September 24, 2010.

<sup>20</sup> See “U.S. TPP Goods Market Access Offer Leaves Some Questions Unanswered,” *Inside U.S. Trade*, February 4, 2011.

existing bilateral PTAs. For the remaining TPP countries, the United States essentially said, “We intend to use the existing bilateral market access schedules as our TPP commitments in goods.” It then did not discuss any goods offers with the remaining countries, preferring to negotiate on a confidential basis with the “missing” four instead.

This tactic was not popular with the remaining TPP members, for three reasons. First, many were hoping to improve on existing PTA treatment. For example, the Australians were hoping to get access to the American market for sugar, plus additional access for dairy and beef beyond their bilateral deal from 2005.<sup>21</sup> Second, the excluded countries had wanted the benefits of a multilateral agreement, particularly for ease of use by business.<sup>22</sup> Third, many negotiators resented the process, especially the confidential nature of the negotiations.<sup>23</sup> Even other ASEAN countries were not allowed to share in the information being exchanged with their ASEAN counterparts. Officials were wary of what sort of commitments were being made and what sort of precedents were being set.

The Americans argued that their use of a bilateral process for the interim negotiations did not, however, rule out the use of a multilateral approach in the end. They managed to convince some partners that this was merely an interim step in the process. New Zealand’s trade minister, Tim Grosser, in fact, argued that “It commits to each TPP member establishing a single schedule - a technical term used to describe legal commitments to open markets to imports - for all the other TPP partner countries. Earlier fanciful notions of a potpourri of separate and often inconsistent

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<sup>21</sup> “Australian Agricultural Exporters Hope for New U.S. Access in TPP, But No Progress So Far,” *Inside U.S. Trade*, March 9, 2012.

<sup>22</sup> Interviews with Singapore officials, May 2011.

<sup>23</sup> Interviews with lead TPP negotiators, especially during Singapore round, June 2011.

schedules - adding even further to the 'noodle bowl' problem - have properly been consigned by Leaders to the waste basket.”<sup>24</sup>

However, careful parsing of the American statements from the November 2011 commitments reveals a certain wishful thinking by New Zealand. What the United States promised was to use a “single schedule” for goods. The term “single” is not the same as a “common” schedule. The former appears to mean merely one amalgamated document where the latter means one document that applies to all nine parties. In the end, it is most likely that the TPP will be a hybrid agreement in which the United States (and potentially other partners) will have both a “common” schedule of commitments and a separate “single” schedule.

### **Opening Markets in New Non-Agricultural Areas**

When the United States first tabled its confidential offers in January 2011, these were viewed with a great deal of interest by other TPP members, as it gave the first concrete glimpse of how expansive the Americans were really willing to be in negotiations. Despite early promises of full market access with no preconditions, the initial offers placed items into four baskets. The first basket would go to zero tariffs on implementation. The second basket contained goods with tariffs to be phased out over five years and the third basket over a ten-year period. Of particular concern was a fairly long list of sensitive items placed into a basket labeled as “undefined,” with no indication of the level of tariff reductions on offer or the length of time expected before reductions might take place.<sup>25</sup> Part of this is a simple negotiating tactic—no excellent official opens talks by revealing the final “offer” at the beginning, but

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<sup>24</sup> Speech at the opening of the Synlait new dairy factory, New Zealand, November 22, 2011.

<sup>25</sup> See “U.S. TPP Goods Market Access Offer Leaves Some Questions Unanswered,” *Inside U.S. Trade*, February 4, 2011.

instead opens with something fairly extreme and works towards a final solution and compromise.

Still, for officials who had spoken at length about the need for a goods negotiation with “no exceptions,” the size of the undefined basket was disheartening. In addition, the products in the undefined basket remained there for a surprisingly long time in the negotiations.

For example, after nearly a full year of talks, the United States and Vietnam had barely budged on most issues related to negotiations over goods.<sup>26</sup> There are at least two interconnected problems in goods trade between these bilateral partners. The primary objective for the United States in goods is greater access to the Vietnamese market for agricultural products. Vietnam would like improved access to the American markets for textiles and footwear.

Vietnam wants two things from the United States: lower tariffs on textiles and apparel as well as simple rules of origin (ROOs). ROOs are discussed in greater detail below, but it is important to note that the two things—market access and ROOs—go hand in hand. It is possible to open the market quite wide with low tariffs but put into place such restrictive ROOs to make it nearly impossible for products to qualify for benefits or to have the reverse situation, with generous ROOs and otherwise relatively high tariffs, and still receive improved market access over the status quo position.

Under the status quo, Vietnamese textile, apparel and footwear exporters currently face a bewildering array of tariffs on exports to the American market. For example, rubber footwear has some of the highest American tariffs that have been maintained through successive rounds of negotiations in the WTO and elsewhere.

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<sup>26</sup> See, for example, “U.S., Vietnam Still Making Slow Progress in Bilateral Talks on Goods Market Access,” *Inside U.S. Trade*, March 7, 2012. Also, interviews with Vietnamese officials in Singapore, January 10, 2012.

Tariff levels of rubber footwear were as high as 37.5% in May 2011. Tariffs are also extremely complicated in rubber footwear. For example, the 2011 rules for HS6402.91.20, “Footwear with outer soles and uppers of rubber or plastics, not waterproof or protective, other than sports footwear, covering the ankle, incorporating a metal toe cap, where less than 90 percent of the surface is rubber or plastics, valued at over \$3 but not over \$6.50 per pair,” is subject to a duty rate of 90 cents per pair plus 37.5 percent. The high tariffs stem in part from a concern over defense needs, but have also become politically entrenched.

Under the TPP negotiations, Vietnamese officials would like to see these complicated tariffs reduced. Up until now, most of these textile, apparel and footwear tariffs have not been addressed in American PTA negotiations—no U.S. partners have had much of an apparel or footwear industry to worry about. In truth, the United States does not have much of a footwear or textile manufacturing industry left to worry about either, but what remains is quite politically powerful. Certainly, it has political power out of proportion to the number of individuals left in these industries. As an illustration, if the United States were to completely open the footwear market to Vietnamese imports in athletic shoes (a key sector), at risk are approximately 900 jobs at New Balance in Maine and 2,000 people nationwide.<sup>27</sup>

Not all shoe jobs are in manufacturing. There are also jobs in American companies like Nike in Oregon<sup>28</sup> and elsewhere in creating athletic footwear in design, research and development and marketing that would be unlikely to be lost if

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<sup>27</sup> Comments of Senator Olympia Snowe (R-ME), at March 7, 2012, Finance Committee hearing, Washington, DC. New Balance does employ 900 persons at five factories in Maine, although it is not clear where the remaining 1100 people Snowe counts are employed. New Balance also makes shoes in Vietnam, as well as in China.

<sup>28</sup> Nike shut its last American manufacturing plant in the mid 1980s in Saco, Maine, and shifted all production overseas. Nike’s largest overseas suppliers are from Vietnam, Ben Bland, “Vietnam Offers Manufacturers China Alternative,” *Financial Times*, March 14, 2012.

U.S. tariffs were cut for Vietnamese imports.<sup>29</sup> Nike, along with the Footwear Distributors and Retailers of America (FDRA), have been pushing to eliminate all tariffs on day one.<sup>30</sup>

Vietnam is now the second largest exporter of footwear to the American market, with exports valued at \$2 billion and sales climbing.<sup>31</sup> American consumers would likely benefit from cheaper athletic shoes if the high tariffs, averaging 15 percent but as low as 12 percent and as high as 37 percent, were cut.

The other challenging non-agricultural issue for negotiations is likely to be automobiles between the United States and Malaysia. This is an issue that proved problematic during the aborted bilateral negotiations in the late 1990s between the two countries. However, the Malaysian government has been taking several important steps to transform the industry and to alter domestic regulations. For example, Malaysia's sovereign wealth fund sold off its stake in the national car company, Proton, to a Malaysian conglomerate in February 2012. Such a move may not signal complete independence from future government intervention in the company. It likely does not mean an end to assorted government protection for the industry, including tariffs barriers, as well as a host of domestic tax and regulatory benefits.<sup>32</sup> Nevertheless, it does suggest that autos will be less a concern in the TPP negotiations than might otherwise have been predicted.

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<sup>29</sup> A Nike spokesperson said the company employs 22,000 workers in the United States. Peter Whoriskey, "New Balance Struggles as Last Major Athletic Shoe Brand Still Manufacturing in U.S.," *Washington Post*, July 29, 2011.

<sup>30</sup> They have also been asking for a simple, across-the-board rule of origin criteria. See the section on ROOs below for the challenges that footwear importers face in qualifying for benefits under PTAs.

<sup>31</sup> China remains the largest exporter, although price pressures have shrunk the size of China's lead, now 85 percent of the U.S. market for imports. "U.S. Industry Divided on Footwear in TPP; Talks Moving Slowly," *Inside U.S. Trade*, March 5, 2012.

<sup>32</sup> See, for example, Vikram Nehru, "Malaysia: Time to Liberalize the Auto Sector," *The Star* (Malaysia), March 2, 2012.

For the remainder of the TPP Four (ie, those countries with which the United States does not currently have a bilateral PTA), there are few issues in non-agricultural market access. The United States and Brunei have essentially no trade together and no issues to discuss in this arena. Most of the New Zealand concerns, as we will note below, are in agriculture.

The rest of the TPP member countries have been bargaining over a common market access schedule. In non-agricultural products, most of these negotiations have been proceeding relatively smoothly. There are few items of concern with high barriers between the remaining partners that have not already been addressed in previous agreements.

### **Agricultural Market Access Negotiations**

The TPP is notable for attempting to pry open closed markets for agricultural products. States have pursued limited liberalization of agricultural markets through the WTO. Some PTAs also include agricultural market access. Many, however, exclude certain highly sensitive items entirely; reduce but do not eliminate tariffs in key areas; allow high tariff peaks to remain; or subject these products to extremely long phase-in periods. In addition, countries can use a range of quantitative restrictions that are not generally allowed in other products. A high-quality, 21<sup>st</sup> century TPP with no exceptions should, as far as possible, avoid all these elements.

Unlike trade in non-agricultural products, there are multiple areas of controversy in opening trade further in agriculture. This is true even in the TPP, although the structure of the current nine members makes negotiations easier than they might otherwise be with a different constellation of participants. Several existing PTA agreements already include robust commitments in agriculture. Two of the

members, Singapore and Brunei, are net food importers with almost no domestic agricultural production.

The current nine partners also do not trade the kinds of products that typically cause problems. For example, although market access for soybeans has been a major issue in multilateral talks in Geneva as part of the Doha Development Agenda of the WTO, soybeans have not struck such a chord among the current TPP members. Barriers to trade in soy products have been largely reduced through bilateral agreements, like the U.S.-Peru PTA.<sup>33</sup>

None of the current nine members has raised much of a fuss over rice, cotton, or corn. This is not, of course, the case with potential members. Knowing that Japan might join the TPP negotiations, meant that the issue of market access for rice will need to be addressed.<sup>34</sup> The problem of rice, however, could serve to both impede and facilitate negotiations. Knowing that rice will be an issue for the TPP in the future means that officials have an incentive now to craft an agreement with minimal (or no) exemptions. Otherwise, Japan could also opt to carve rice out of any future agreement.<sup>35</sup>

The most problematic issues among the nine have been pork, sugar, beef, and dairy. Pork is a primary objective for American exporters hoping to break into Vietnam's lucrative and growing market. This, however, has so far been held back by difficult negotiations over textiles and footwear. Until progress takes place in textiles and footwear, Vietnam has been unwilling to discuss market access for pork products.

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<sup>33</sup> Tariffs on soybeans, soy meal and flour and crude soybean oil were eliminated immediately, with TRQ out of quota tariffs phased out over 10 years.

<sup>34</sup> Other agricultural items that are sensitive for Japan include beef, dairy, and wheat. Interview with Japanese METI officials, July 2011.

<sup>35</sup> TPP lead negotiators have been quite clear in bilateral discussions with Japan over the need for Japan to brace for at least some liberalization of rice as part of the 'price' of admission to the TPP.



Tariffs are not the only issue plaguing trade in agriculture. Negotiators also have to deal with quantitative restrictions, known as tariff-rate quotas (TRQs). Under a TRQ system, products are generally assigned two tariff rates and a specified quantity of imports allowed. The first, lower, tariff rate applies for all imports of products up to the quota. A second rate (frequently much higher) applies for all imports above the quota.<sup>36</sup> In the WTO, the Uruguay Round Agreement on Agriculture (AOA) established over 1,425 TRQs, mostly used by developed economies. TRQs can be set up as ‘supplier tariff quotas,’ or are country-specific rather than being open for imports from all WTO member states.<sup>37</sup>

TRQs have followed in PTA negotiations. For example, under the U.S.-Peru agreement, the United States provided Peru with a 9,000 ton sugar TRQ and an additional 2,000 ton TRQ for specialty sugar.<sup>38</sup> This allows Peruvian exporters to ship up to 9,000 tons of sugar per year to the United States, provided that Peru is a net exporter of sugar and that the United States does not choose to invoke its right to provide compensation in lieu of accepting imports. This example highlights both the complexity of the TRQ administration as well as some of the mechanisms that can be used to prevent imports.

The 9,001<sup>st</sup> ton of sugar exported by Peru is subject to significantly higher tariff rates. Note that if the TPP succeeds in removing TRQs, presumably the TRQ in

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<sup>36</sup> If the second, out-of-quota tariff was set high enough, the entire formula effectively reduces to an import quota.

<sup>37</sup> This allows discrimination to take place within the WTO. Note that TRQs have been the subject of many disagreements and disputes in the WTO system, particularly about the methods of determining country specific quotas and the non-transparent administration of some country's systems.

<sup>38</sup> The former quota also expands at two percent simple annual growth per year, while the latter does not expand over time with growth. See ‘U.S.-Peru Trade Promotion Agreement Fact Sheet,’ U.S. Department of Agriculture, September 2009.

the U.S.-Peru deal also *de facto* goes away, allowing Peru to export sugar in significantly higher quantities than it is currently allowed.

Given that Peru already has a PTA with the United States, its complex rules on sugar in the bilateral are not currently up for negotiation within the TPP, but, if they were, Peru would presumably be seeking both tariff reductions and quota changes, just like Australia. Australia exports about 3 million tons of raw sugar each year and 250,000 tons of refined sugar.<sup>39</sup>

New Zealand is currently subject to tariff rate quotas on U.S. beef.<sup>40</sup> In 2011, New Zealand was allowed exports of nearly 214,000 tons at a tariff rate of US\$.04.4 cents/kg, with an out of quota rate of 24.6 percent.<sup>41</sup> New Zealand would like to gain greater access to the American market for beef exports. This includes not just lower tariffs, but also either the elimination of the TRQ or the expansion of the quota allocation for New Zealand beef exports.<sup>42</sup> The United States is the largest market for New Zealand beef exports, exporting 158,761 tons in 2010, for a total share of nearly 42 percent of New Zealand's global exports.<sup>43</sup>

For Australia, the bilateral agreement on beef will not result in complete liberalization until 2023. Until then, Australian beef exporters have a sliding TRQ

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<sup>39</sup> Of the refined sugar exports, 150,000 tons go to Singapore. Australia has a sugar TRQ for the United States under the WTO, but none under the bilateral agreement. "Australian Agricultural Exporters Hope for New U.S. Access in TPP, But No Progress So Far," *Inside U.S. Trade*, March 9, 2012.

<sup>40</sup> These quotas on beef were not filled in 2010.

<sup>41</sup> The New Zealand government then allocates the quota to specific producers within New Zealand. See 'Quota Management: USA Beef and Veal,' *New Zealand Meat Board*, 2011. Australia was also subject to quotas, including in the U.S.-Australia PTA. Australia's quota was 378,214 tons. See 'Livestock and Grain Market News,' *International Meat Review*, USDA Volume 15, No. 14, July 7, 2011.

<sup>42</sup> The proposed solutions, however, to some of these complexities could be as bad as the original problem. For example, if the TRQs on beef were removed in the TPP negotiations, the U.S. Cattleman's Association suggested using a quantity-based safeguard during a phase-out period and the potential for a tariff snapback if imports surge. "USTR Announced New Zealand FTA Gets Cool Agriculture Reaction," *Inside U.S. Trade*, September 26, 2008.

<sup>43</sup> The share of U.S. exports has been trending downward. See 'New Zealand Cattle and Beef Semi-Annual Report,' *Global Agricultural Information Network*, GAIN Report Number NZ1103, March 4, 2011.

that reduces the 26.4 percent over-quota rate downward and expands the quantity of the quota gradually to a maximum of 448,214 tons in 2023.<sup>44</sup> Australia is not filling the TRQ on beef established in the bilateral PTA with the United States. However, beef exporters have still lobbied the government to remove the rules in the TPP, if possible, and at a minimum, to speed up the 18 year phase out period established in the 2005 bilateral agreement.

One of the most hotly contested items in goods negotiations in the TPP is movement of dairy products, especially for cheese, butter and milk solids, which are generally subject to high tariffs, as well as TRQs. The United States and New Zealand have never held bilateral negotiations before and both have globally competitive dairy industries. One of the primary offensive interests for New Zealand for the entire TPP talks is to gain greater access to the American market for dairy. However, after nearly two years of negotiations, serious offers have not yet been made.<sup>45</sup> New Zealand wants complete liberalization of the sector, although it appears flexible about the timing of opening and the process of getting there.<sup>46</sup>

What appears to be holding up negotiations at this point is a differing perspective on the nature of the problem. For the United States, dairy farmers have long argued that New Zealand's dairy trade is represented by one company, Fonterra. As a monopoly it has unfair trade advantages. Fonterra is in control of 90 percent of the market and has substantial barriers to entry into the market.<sup>47</sup> If the American

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<sup>44</sup> "Australian Agricultural Exporters Hope for New U.S. Access in TPP, But No Progress So Far," *Inside U.S. Trade*, March 9, 2012.

<sup>45</sup> "U.S., New Zealand, Far from Detailed Dairy Market Access Negotiations," *Inside U.S. Trade*, March 9, 2012.

<sup>46</sup> Interviews with New Zealand officials, Wellington, October 2009.

<sup>47</sup> The WTO's review of New Zealand (2003) found that dairy was no longer a monopoly, but the company has exclusive licenses to export to some markets from 2010 onwards. Fonterra (USA), Inc. submitted a letter to USTR during the open comment period (through the legal firm of Blank, Rowe, LLP, on March 11, 2009). It argued that the market in New Zealand was open for competition, with no government subsidies, import tariffs or quota restrictions.

market is opened to competition through a PTA like the TPP, dairy farmers fear that New Zealand dairy will receive unfair competitive advantages.<sup>48</sup>

As an example, the U.S. Dairy Export Council highlighted deep reservations about the problems of competition in the monopolistic New Zealand dairy industry, which also controlled nearly 1/3 of all global dairy trade.<sup>49</sup> In addition to rising problems of direct competition,<sup>50</sup> a TPP agreement that included dairy would undermine some important gains from trade as, for example, New Zealand and Australia would become more competitive in the Peruvian market (where neither state currently has an PTA in place).

New Zealand has long argued that Fonterra is not a government monopoly, but a farmer cooperative. Fonterra has branches all over the world, including one in the United States, who argued for USTR that the entire New Zealand dairy industry was smaller than that of California and that it was no more globally competitive than American dairy in various export markets. In addition, New Zealand has not been filling the dairy quotas into the American market lately, particularly for cheese. This suggests that fears of a New Zealand juggernaut in dairy are overblown.

However, given the importance of the dairy industry to the New Zealand economy, this is one area where New Zealand officials believe they cannot afford to

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<sup>48</sup> Jaime Castaneda estimates that U.S. dairy producers would lose gross revenues of \$20 billion over the first ten years of an PTA. See Testimony, NMPF Producers Federation, March 4, 2009. Land O'Lakes was more careful, but urged USTR to look carefully at New Zealand's dairy industry for anti-competitive outcomes. See their submission to USTR, March 9, 2009. The National Confectioners Association asked for immediate liberalization of dairy from New Zealand, as it would bring about substantial benefits for their producers, who were forced to manufacture sweets with the highest-priced sugar and dairy in the world. See their USTR submission on March 10, 2009.

<sup>49</sup> Thomas Suber, testimony submitted by the U.S. Dairy Export Council, March 10, 2009.

<sup>50</sup> This is happening in any case, as New Zealand dairy exports have risen from \$454 million in 2004 to \$704 million in 2008. See testimony filed by the U.S. Dairy Export Council, March 10, 2009.

start “negotiating with itself” by offering less ambitious alternatives.<sup>51</sup> An agreement will eventually have to include at least some increase in market access for dairy products into the U.S. market.

### **Arguments Over Rules of Origin in the TPP**

The TPP is a preferential trade agreement. It means that goods transiting between members must be able to demonstrate that they are “from” a member state in order to take advantage of the benefits conferred by the agreement like lower tariff rates. The rules must also be capable of distinguishing goods that are not “from” members to ensure that these non-originating goods are not eligible for the benefits of the agreement. If these rules of origin (ROOs) were not put into place, any firm from any country could take advantage of any PTA. In the existing PTAs signed among various TPP member countries, the ROOs vary.

Crafting ROOs is trickier than it first appears. They have to be written in such a way that encourages business to take advantage of all the benefits offered by the agreement. If the rules are too complicated, business will simply export and import goods under multilateral rules governing trade or use a different PTA agreement. Negotiations in the TPP have been difficult because each of the TPP partners have different ideas about what is the right mix of rules to ensure that only TPP businesses can benefit from the agreement while also guaranteeing that non-TPP firms will be kept from gaining preferential access to the markets.

For items that are wholly produced in a TPP member country, like beef that is grown, slaughtered, and packaged in one member before being shipped for consumption in another member, determining origin is not so difficult. However,

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<sup>51</sup> As noted in *Inside U.S. Trade*, “U.S., New Zealand Far from Detailed Dairy Market Access Market Negotiations,” March 9, 2012.

increasingly firms do not obtain all the components of a product solely from domestic sources—from raw materials through packaging. At issue is how much of a product’s content must be from TPP members to qualify as originating in the TPP.

For products are that not wholly originating, they must be somehow “substantially transformed” by a member state firm in order to qualify for benefits. This is not the place to get into the technical details about how a product might demonstrate that it has been substantially transformed. Instead, it is sufficient to note that there are multiple methods that can be used to calculate transformation.

TPP officials have found themselves bargaining hard over two issues related to ROO calculations. First, what should be the right methods for calculating origin? Each method has different advantages and disadvantages. Some are easier for businesses to use than others. The easiest approaches of all allow business to use multiple methods. But officials who do not want to open markets very far can also argue for using more complex ROO methods with heavy data requirements. Or they can have certain tariff lines subject to different ROO calculation methods than other tariff lines.<sup>52</sup>

A second controversial issue is how much transformation must take place in the TPP for a product to “count” as made in the TPP? The technical term for this is cumulation and it allows a firm to add inputs from multiple TPP member countries together in calculating the originating content of a product. Cumulation is an important concept, especially for the TPP that has repeatedly emphasized the role that

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<sup>52</sup> This is what is currently done in footwear in the United States, for example. In addition to complex tariffs, the ROOs for footwear are equally complicated in existing PTAs. For example, in the U.S.-Korea FTA, 15 tariff lines have to meet a much tougher calculation method for origin, including waterproof footwear and sports or athletic footwear. “Debate Over U.S. Position on Footwear Tariffs in TPP Focuses on Tariffs and Rules of Origin,” *Inside U.S. Trade*, March 5, 2012.

the final agreement can play in facilitating trade in supply chains throughout TPP member countries.

For example, if a firm wants to make orange juice in Singapore using oranges sourced from Indonesia with water from Singapore and packaging from Malaysia to be shipped to the United States, could the final product be counted as a TPP originating good for eligibility under TPP lower tariffs for orange juice? The answer is that it depends on how the rules are ultimately crafted in the TPP. An expansive ROO with regional cumulation rules would likely allow a Singapore company to take advantage of the transformation of oranges, water and packaging into juice for shipment into the United States at a lower tariff rate. However, if negotiators ultimately wanted to keep markets closed, they could also craft ROOs strict enough to make this impossible for the Singapore firm to qualify for benefits.

An open, comprehensive goods agreement might also be expected to have the broadest possible ROO scheme in place. For example, it is possible to imagine a single ROO for all goods in the TPP. In this case, it would have to either determine one method of calculating transformation<sup>53</sup> or allow multiple calculation methods<sup>53</sup> and then have region-wide cumulation rules. It is only with the broadest, most liberal interpretation of ROOs that governments have the best shot of unraveling the noodle bowl of overlapping PTAs.

This is not, however, the direction of the TPP two years into negotiations. Instead, largely driven by American interests, the ROO rules have two components that are particularly problematic from the perspective of allowing open and comprehensive trade in goods. First, they have crafted product-specific ROOs and

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<sup>53</sup> Using multiple methods, business could choose whichever method allowed their products to meet the origin criteria under a “co-equal” rule.

second, they have recreated a whole series of specific rules just for textile and footwear products. Each is discussed in turn.

Rather than create a broad ROO or even a broad set of ROOs for specific sectors, negotiators, as an example, spent a whole mini-round of negotiations in early December 2011 working through the tariff schedules line-by-line just for chemical products to create ROOs for each individual line. This means that chemical companies interested in shipping chemicals to TPP member countries will have to follow ROOs that may be specific for each different kind of chemical in their inventory. Some of the chemicals they plan to export will qualify for preferential benefits and others will not. These product-specific ROOs are now to be found throughout the TPP in other sectors as well. Every product-specific ROO undermines the open and comprehensive nature of the final agreement.

Although the rules on cumulation have not yet been set, the Americans have been pushing for higher thresholds than other TPP members have been advocating. In footwear, for example, New Balance would like to have a 55 percent value added rule for certain tariff lines.<sup>54</sup> This means that at least 55 percent of the total value contained in any athletic shoe must originate in a TPP member country before it can be shipped under lower TPP tariffs into TPP member markets. Shoes that contain, say, only 40 percent value added would not be eligible for lower tariffs and must pay the higher duty rates applicable to non-member imports.

Higher thresholds means that fewer products will be eligible for benefits, especially from smaller economies, who are less likely to be able to produce a product using only components and raw materials from the domestic level. The example of

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<sup>54</sup> Fifty five percent is a very high threshold for a ROO. However, in footwear, because the Vietnamese industry is quite vertically integrated domestically, it is actually likely that most exports would meet this strict criteria anyway. "Debate Over U.S. Position on Footwear Tariffs in TPP Focuses on Tariffs and Rules of Origin," *Inside U.S. Trade*, March 5, 2012



athletic shoes also shows how ROOs and tariff levels work in tandem to open and close off access to markets.

Another distinctly non-21<sup>st</sup> century rule is the American insistence on a yarn-forward ROO for textiles. This rule will require textile and apparel producers to use yarn produced in a TPP member country forward at every stage of production of a garment in order to qualify for preferences into the TPP markets.<sup>55</sup> The draft rules proposed by the United States makes Chinese-made yarn (or any other non-TPP county yarn) ineligible for benefits, essentially requiring firms to use American yarn (as the only TPP member country to manufacture yarn in substantial quantities) if they hope to take advantage of lower tariffs.

These rules are not universally popular, even among American firms. The United States Trade Representative's Office, USTR, has received strong pushback against them, especially by apparel companies, who see yarn-forward rules as contributing to higher clothing costs for consumers. Julie Hughes, President of the U.S. Association of Importers of Textiles and Apparel noted, "The yarn forward style rule of origin is outdated and unworkable and does not reflect the commercial realities of global value chains."<sup>56</sup>

Vietnam has proposed a different ROO for textiles, one called "cut and sew." Under cut and sew, apparel items could be cut and sewn from fabric made in any country, as long as the final product was substantially transformed in a TPP country before final shipment to another TPP country. This would allow Vietnam to continue using largely Chinese fabrics for its apparel industry and still obtain the lower tariffs

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<sup>55</sup> Other elements of the U.S. textile package includes market access, safeguards against an import surge to protect American textile workers, and various customs procedures to protect against transshipment of goods. "Marantis Promotes U.S. Yarn-Forward Rule of Origin in TPP Negotiations," *Inside U.S. Trade*, December 19, 2011.

<sup>56</sup> See the Trans-Pacific Partnership Apparel Coalition Letter to U.S. and Peruvian Negotiators, February 10, 2012.

for garments in the TPP. The cut and sew rule is supported by large segments of the U.S. apparel industry.

The rest of the TPP members do not have textile or footwear industries, so they are largely unengaged in these negotiations. However, they are following the discussions closely. The remaining seven members would prefer simplified ROOs wherever possible, even in textiles.

Whatever rules are ultimately created, the system of ROOs will be very complex. This is especially so if the final tariff schedule is a hybrid system containing ten schedules—one in common across all nine members as well as nine separate bilateral schedules. Each of these tariff lines may, potentially, have a matching ROO.

To add a final layer of complexity to the whole system, the interim steps of the agreement will be even more convoluted. Recall that tariff reductions will likely take place in stages. These interim steps will have to be managed across nine countries and over ten different tariff schedules. Consider the logistics of managing the merger of Mexico into the existing United States-Canada agreement. When Mexico joined the existing U.S.-Canada PTA to form the North American Free Trade Agreement (NAFTA), officials had to devise a scheme to keep in place the existing PTA benefits of the U.S.-Canada agreement that was already in force while simultaneously phasing in tariff reductions for Mexican goods.

As an example, suppose a manufacturer of nails was eligible for zero tariffs under the Canada-U.S. PTA while Mexican nails were still subject to an interim tariff of six percent. Officials created a rule that all incoming products needed to be marked with a country of origin label in order to differentiate between Canadian, American

and Mexican nails crossing the border.<sup>57</sup> Customs officials could subsequently apply the correct tariff rates to the particular shipment. However, the calculation of tariffs was made more difficult, became more complex, in the meantime. Furthermore, as tariffs were phased out over time, the calculations for our hypothetical example of nails would change from year to year across the time period of the phase out. To expand this system across nine or more TPP member countries will be logistically difficult, time consuming and cumbersome.

### **How Yarn Could Yet Unravel the Whole Agreement**

Negotiations between the United States and Vietnam have barely budged in the year since the first goods offers were exchanged. Part of the issue seems to be one of differing tactics. The Americans appear to have had hoped that they could begin with the “easy” items on the agenda and build up to the difficult items. For the Vietnamese, however, some of their most cherished objectives in the entire TPP negotiations can be found in the goods negotiations with the Americans. They need to obtain greater market access for textiles, apparel and footwear. This means not just lower tariffs, but also simple ROOs. Without a breakthrough in these areas, the TPP will not bring the benefits sufficient to offset the costs that Vietnam will have to “pay” in other areas of the TPP. This includes areas like wholly new commitments on State-Owned Enterprises (SOEs), liberalization in services and investment, new rules on intellectual property, or market opening in government procurement. Therefore,

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<sup>57</sup> The marking rule still exists for most products in NAFTA, although the tariffs are now harmonized across all three countries. The issue could be minimized in the TPP by the use of a single rule of origin (ROO) calculation method, but since this will conflict with some of the ROOs currently contained in existing PTAs, it is also likely that some product-specific, country-specific ROOs will continue in the TPP if existing agreements are not replaced. See “U.S. Mulls NAFTA-like Marking Rules to Determine Tariffs under TPP,” *Inside U.S. Trade*, Vol. 28, No. 37, September 24, 2010.

the Vietnamese government seems to have calculated that, absent a breakthrough on goods in textiles, apparel and footwear, there is simply no point in discussing the rest of the goods agenda.<sup>58</sup>

Since the United States has been unwilling so far to bend from its insistence on the yarn-forward rule of origin and Vietnam is demanding a cut-and-sew rule, no breakthrough has been possible. Negotiations have been taking place on a bilateral basis and not multilaterally in goods. This has meant that the strength of other TPP members cannot be brought to bear on the issue either.

This impasse over goods—and more specifically over textiles and footwear—has also limited progress across a wide range of topics elsewhere in the TPP negotiations. From Vietnam’s perspective, if the United States is not willing to engage in its most cherished objectives, it is difficult to see why they should discuss issues that are dear to the heart of the Americans.

Although not yet to the same extent, New Zealand is also growing increasingly impatient with the United States. Officials must be able to come home from the final agreement with some sort of new market access in dairy (at a minimum). So far, no breakthrough has taken place.

### **21<sup>st</sup> Century Elsewhere, But Not in Goods**

In November 2011, the leaders of the TPP countries issued the “broad outlines” of a final agreement. In this document, the leaders noted that the final agreement must include “comprehensive market access that eliminates tariffs and other barriers to goods.” This is an ambitious goal, especially when paired with the repeated statements of officials to offer access with “no exceptions.” Such market

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<sup>58</sup> Interviews with Vietnamese officials, in Hanoi, December 1-2, 2011, and Singapore, January 10, 2012.

access in goods trade is indeed rare. It is also a difficult goal, especially when pursued across nine countries on three continents with differing levels of economic development and differing levels of economic openness.

Overall, the TPP aims to be a different kind of agreement—one that is of high quality and includes substantially new coverage. While this may be true for the agreement as a whole, in goods trade more specifically, the agreement does not live up to these lofty goals and ambitions. In goods trade, largely because of the parochial demands of the Americans, market access in goods and the matching rules of origin now being crafted bear the distinct imprint of old, 20<sup>th</sup> century agreements. Worse yet, unless some key compromises take place quite quickly in the negotiations, the entire agreement could founder on some relatively minor market access issues for the United States.

Free trade in goods in the TPP appears to be hampered by decisions on negotiating structure that leaves officials bargaining bilaterally in a multilateral setting; by specific decisions over market access in non-agricultural goods, especially limited tariff cuts in textiles and footwear into the American markets; by problems in opening markets in agricultural goods; and by extremely complex rules of origin exemplified by yarn forward rules for textiles and other product-specific rules that will constrain the movement of goods across TPP member states. Each of these elements increases the risk that business will not take advantage of the provisions of the final agreement because the rules are too complex and the benefits too small. If business does not use the preferential access crafted by government, this PTA will not have the economic impact its leaders had intended.

The TPP is more than simply an agreement about trade in goods. But, with all the focus on the new elements in the Trans-Pacific Partnership talks, it looks very

much like the most basic component of any free trade agreement—improved movement of goods across member borders—may be bringing up the rear.

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