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Canada and the Trans-Pacific Partnership

Entering a new era of strategic trade policy

by Laura Dawson and Stefania Bartucci

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Executive summary

The Trans-Pacific Partnership trade agreement will secure a trade alliance between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The combined economy of these countries is over \$27 trillion, nearly 35 percent of global GDP and about one third of global trade. If the deal goes through, the TPP could yield annual income gains of \$9.9 billion for Canada and increase exports by \$15.7 billion. Moreover, the TPP has the potential to expand to include all Asia-Pacific Economic Cooperation countries (APEC), providing for greater market access gains in the future.

Many of the TPP members are rapidly growing economies with young populations. Enhanced trade access to these markets will benefit Canada as these economies develop and their citizens become wealthier. Another attraction of the TPP is the possibility of engaging China, which has expressed some interest in the agreement. If it were to join, the TPP would become the first regional agreement to include the world's three largest economies: the United States, China, and Japan.

However, the TPP does not offer Canada strong market access gains in the short term; instead, the agreement is important for a series of strategic and defensive reasons. When Canada negotiated the NAFTA and WTO agreements in the early 1990s, issues such as electronic commerce, digital media, and third-party logistics had not yet entered the commercial mainstream. The TPP agreement provides a platform for discussing and resolving these and other emerging issues. Furthermore, the TPP also offers a defense against the erosion of NAFTA preferences. Canada's presence at the negotiating table helps to ensure that the terms of the final agreement are at least consistent with NAFTA so that Canada does not have to undertake costly reforms to adapt to a new system. The TPP also offers the opportunity to streamline rules of origin and harmonize customs procedures and technical standards, which will reduce production costs for Canadian businesses. Finally, because the TPP negotiations include coverage of competition, investor protection, regulatory coherence, sanitary and phytosanitary measures, and technical barriers to trade, among other issues, the trade deal will become a vehicle by which transparency and ease of doing business are improved in emerging markets.

Canada's trade rules and procedures are already strongly aligned with those of the United States and, as such, implementation of the TPP should not be costly. There has been much speculation as to whether Canada's participation in the TPP would require us to dismantle our supply management system for dairy, poultry, and eggs. However, with Japan's entry into the TPP negotiations, the odds for countries wishing to exempt sensitive sectors from TPP disciplines may improve: Japan's protective policies for its domestic rice sector are well known and unlikely to be dismantled. If its rice protections remain, this will open the door for other members to shield their sensitive industries.

Canada gains from the TPP not only by expanding its economic partnerships but also by playing a significant role in shaping the rules that will govern trade relationships in the twenty-first century. By being at the table, Canadian negotiators can put forward proposals and amendments so that the rules will suit our interests, such as standardized disciplines on trade and investment by state-owned enterprises that are consistent with those recently added to the Investment Canada Act, and new mechanisms to minimize "buy local" provisions in government procurement arrangements. The era of easy trade policy gains may be over, but the disciplines imposed by the TPP on investment, regulatory alignment, rules of origin, and market access will, in the longer term, help to increase certainty, reduce risk, and lower costs for Canadian exporters and investors in emerging markets.

Overview

The Trans-Pacific Partnership (TPP) trade agreement currently under negotiation will secure a trade alliance between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. These countries have a combined economy (GDP) of over \$27 trillion, comprising nearly 35 percent of global GDP and about one third of global trade (USTR, 2013). Researchers Peter Petri and Michael Plummer (2012) estimate that the TPP could yield annual income gains of \$9.9 billion for Canada and increase exports by \$15.7 billion.

This “ambitious, next-generation” trade agreement (USTR, 2011) will be Canada’s first foothold into prosperous Asian markets and will provide an opportunity for Canada to address outstanding issues with its two NAFTA partners. To date, the WTO has been the most significant and promising forum for multilateral trade liberalization, but negotiations have stalled and they are not likely to pick up momentum in the near future. As such, TPP membership is likely to broaden to include other countries seeking to liberalize trade relationships, such as the Philippines and South Korea. In May 2013, China announced that it is launching a study on the benefits and challenges of joining the TPP (*Shanghai Daily*, 2013, May 31). Although the prospect of China joining the negotiations in the short term is uncertain, the country’s expression of interest underscores why the TPP is important: it has the potential to expand to include all Asia-Pacific Economic Cooperation countries (APEC). For countries in the Asia-Pacific region, the main draw of the TPP is preferential access to the United States. The United States’ commitment to the TPP as the centrepiece of its foreign trade strategy means that these negotiations may avoid becoming mired in politics and yield a finished agreement within five years.

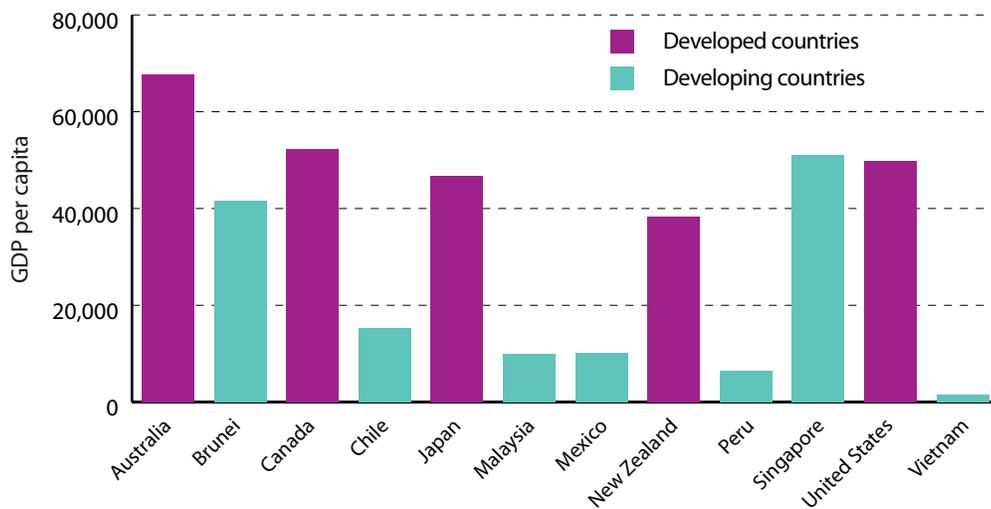
Market opportunities

A young and dynamic region

For Canada, one of the main attractions of the TPP is enhanced trade access to emerging, dynamic markets. Many of the TPP members are small but wealthy economies. The average per capita GDP in TPP states, for instance, is over \$32,000 (**figure 1**). As emerging-market consumers enter the middle class, they become interested in purchasing the goods and services that Canada has to offer, including energy and food products, as well as financial, business, and construction services.

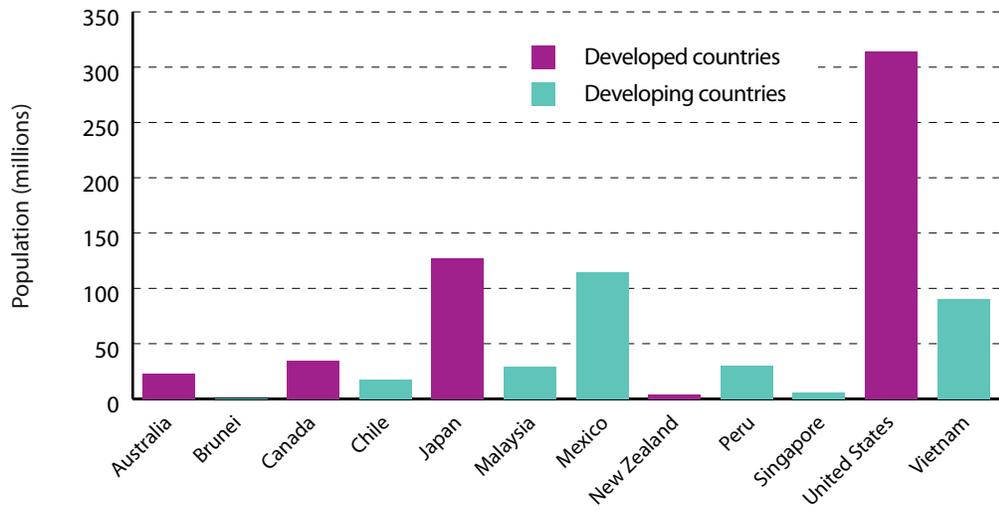
The TPP countries are home to nearly 800 million people, making them collectively one of the largest economic regions in the world by population (**figure 2**). It is also a relatively young region, with a median age of about 33 years (**figure 3**). In countries such as Malaysia, Mexico, and Peru, a

Figure 1: Per capita GDP of TPP states, 2012 (\$US)



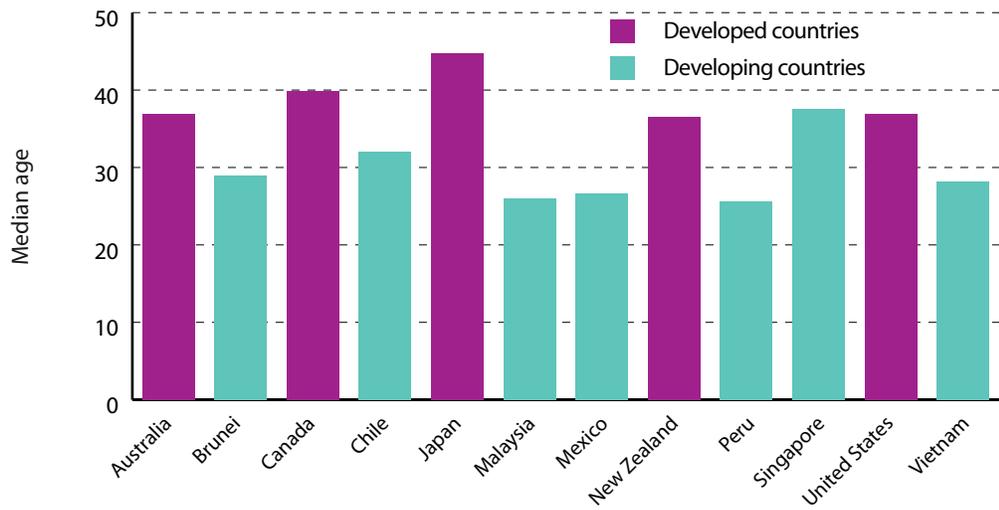
Source: IMF, 2013.

Figure 2: Population of TPP states, 2012 (millions)



Source: United Nations, Department of Economic and Social Affairs, Population Division, 2011.

Figure 3: Median age of population of TPP states, 2010



Source: United Nations, Department of Economic and Social Affairs, Population Division, 2011.

relatively larger share of the population is entering the workforce and remaining there longer prior to retirement, contributing to both economic output and consumption. Countries such as Japan, Canada, the United States, and Australia are facing aging populations whose consumption tends to drop after retirement. As a result, it makes economic sense for Canada to seek out “younger” trading partners.

The possible inclusion of China would significantly increase the economic importance of the TPP (**table 1**). With a population of more than 1.4 billion and annual growth rates in excess of eight percent, China is projected to be one of world’s fastest-growing economies well into the next decade (IMF, 2013). If the TPP included China, it would be the first regional agreement to include the world’s three largest economies: the United States, China, and Japan. These states alone account for about 40 percent of global GDP.

Table 1: Market potential of TPP states, with China

	GDP, 2012 (billions of \$US)	Population, 2012 (millions)	GDP per capita, 2012 (\$US)	Median age of population, 2010
Australia	1,541	22.8	68,000	36.9
Brunei	17	0.393	41,703	28.9
Canada	1,819	34.8	52,231	39.9
China	8,227	1,354	6,075	34.5
Chile	268	17.4	15,410	32.1
Japan	5,963	127.6	46,735	44.7
Malaysia	304	29.5	9,941	26
Mexico	1,275	115	10,247	26.6
New Zealand	169	4.4	38,221	36.6
Peru	199	30.5	6,530	25.6
Singapore	276	5.4	51,161	37.6
United States	15,684	314.2	49,922	36.9

Sources: IMF, 2013; United Nations, Department of Economic and Social Affairs, Population Division, 2011.

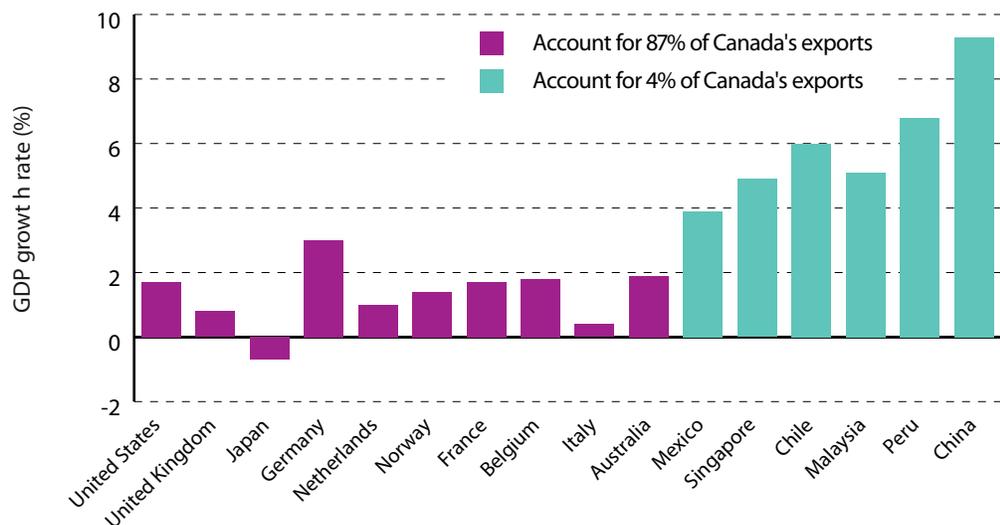
Seeking growing markets through diversification

Canada has traditionally traded with advanced, industrialized economies, such as the United States and Western Europe, which are now experiencing slow or stagnant growth. Diversification, first to Mexico in 1994 through NAFTA and more recently to China through the WTO, is helping to generate new market opportunities, but high-growth economies still receive less than five percent of Canada's exports (**figure 4**). Among TPP states, growth rates in countries such as Singapore, Chile, Malaysia, and Peru are two and even three times that of the United States. Most importantly, growth rates in TPP emerging markets are predicted to remain relatively high over the next several years (**figure 5**). This rapid growth in wealth will provide even greater future market opportunities for Canadian companies in TPP states.

Focusing on market potential

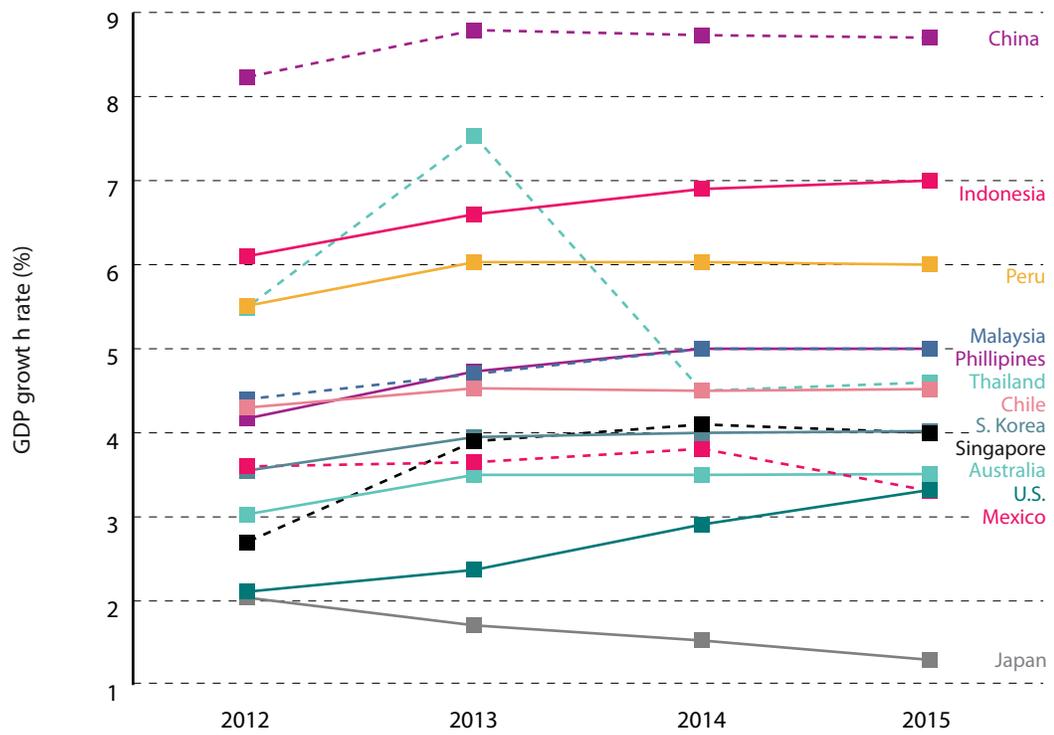
Most of Canada's exports of manufactured goods continue to go to the United States. Exports to our other top trading partners, such as China, the United Kingdom, and Japan, are much lower (**figure 6**), and exports to potential TPP trading partners are even lower still (**figure 7**). Nevertheless, given the shifting dynamics of global growth to emerging markets, Canadian businesses must focus on market potential, rather than where the markets are now.

Figure 4: Canada's trade with slow-growing and fast-growing economies, by GDP growth rate, 2011



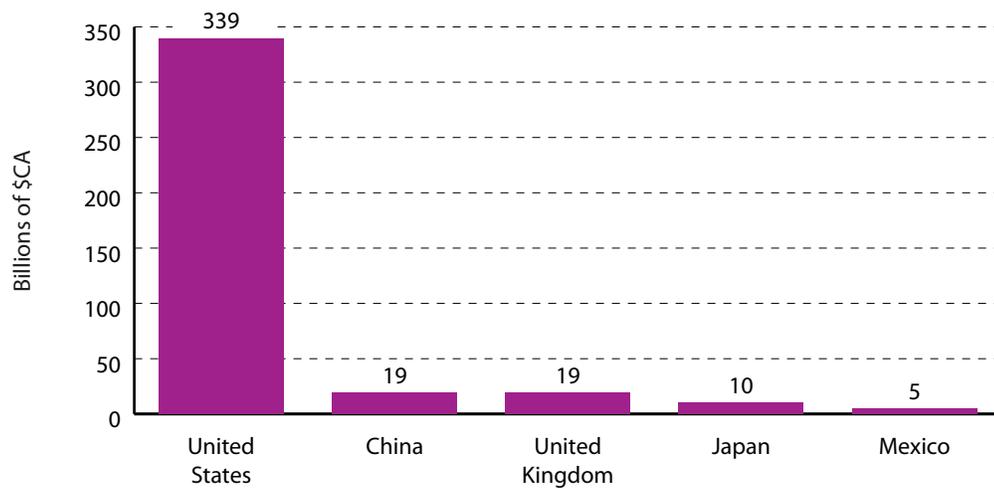
Sources: World Bank, 2013; Industry Canada, 2013.

Figure 5: Projected GDP growth to 2015, selected TPP and APEC countries

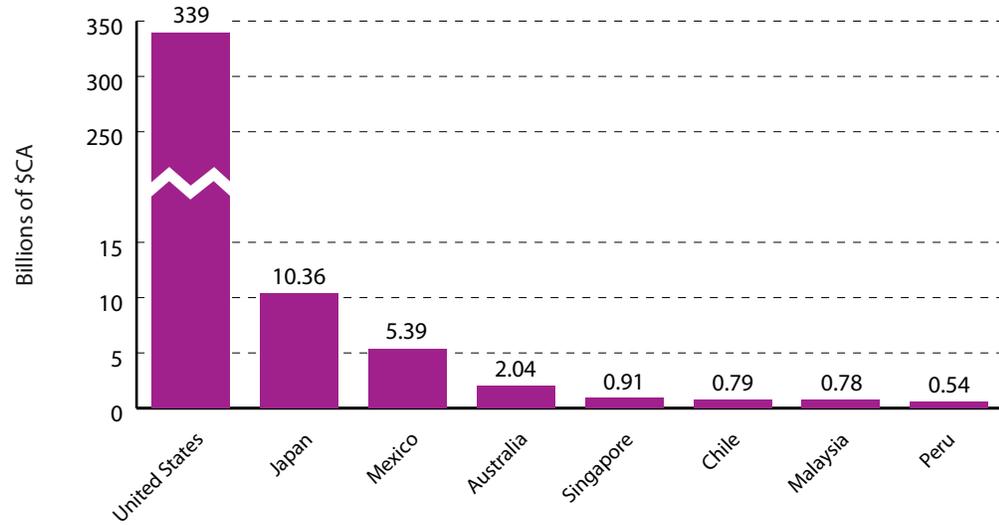


Source: IMF, 2013.

Figure 6: Canada's exports to top five trading partners, 2012 (billions of \$CA)



Source: Industry Canada, 2013.

Figure 7: Canada's exports to top TPP countries, 2012 (billions of \$CA)

Source: Industry Canada, 2013.

A strategic trade policy

As well as offering Canada a foothold in emerging markets, the TPP is important for strategic reasons: it provides a platform for new trade issues, a defense against the erosion of NAFTA preferences, a way to simplify trade and reduce transaction costs, and a vehicle to improve transparency in emerging markets.

A platform for new trade issues

With the present Doha Development Round of WTO negotiations yielding little of substance, the TPP provides an opportunity for Canada to develop international trade obligations on a host of new issues.

Aside from ongoing negotiations towards a Comprehensive Economic and Trade Agreement (CETA) with the European Union, Canada's last major comprehensive free trade negotiations occurred two decades ago with NAFTA and the WTO Uruguay Round. The resulting agreements provided a template for the form and coverage of modern trade agreements and how the subjects of these agreements would be treated. Although the outcome of the CETA negotiations is uncertain, if an agreement is reached, it is expected to further liberalize goods and services market access for European companies doing business in Canada and provide Canadian businesses with expanded EU commitments in the areas of automobiles, beef, government procurement, and investment—well beyond the benchmark commitments of the WTO agreements.

Canada negotiated the NAFTA and WTO agreements in the early 1990s, before such issues as electronic commerce, digital media, and third-party logistics entered the commercial mainstream. Although there were evergreening elements built into the agreements—such as periodic rounds of new negotiations for the WTO and regular working group meetings for NAFTA—both have suffered from neglect and a lack of political will to reopen old agreements.

Commenting on the United States' apparent preference for the TPP over NAFTA as a negotiating forum, former United States Trade Representative Robert Zoellick (2013) argues that Congress has been a prime motivator for the United States to seek ambitious new agreements rather than improve

upon old ones. Representatives believe that they have a better chance of promoting constituent interests in new agreements and they risk losing gains already won by reopening old agreements. Using new agreements to generate improvements to old agreements may be an indirect route to reform, but it can be effective if commitments achieved in older agreements are refined in subsequent agreements. For example, because all three NAFTA signatories are also parties to the TPP, any new TPP commitments that are deeper than those in NAFTA will take precedence.

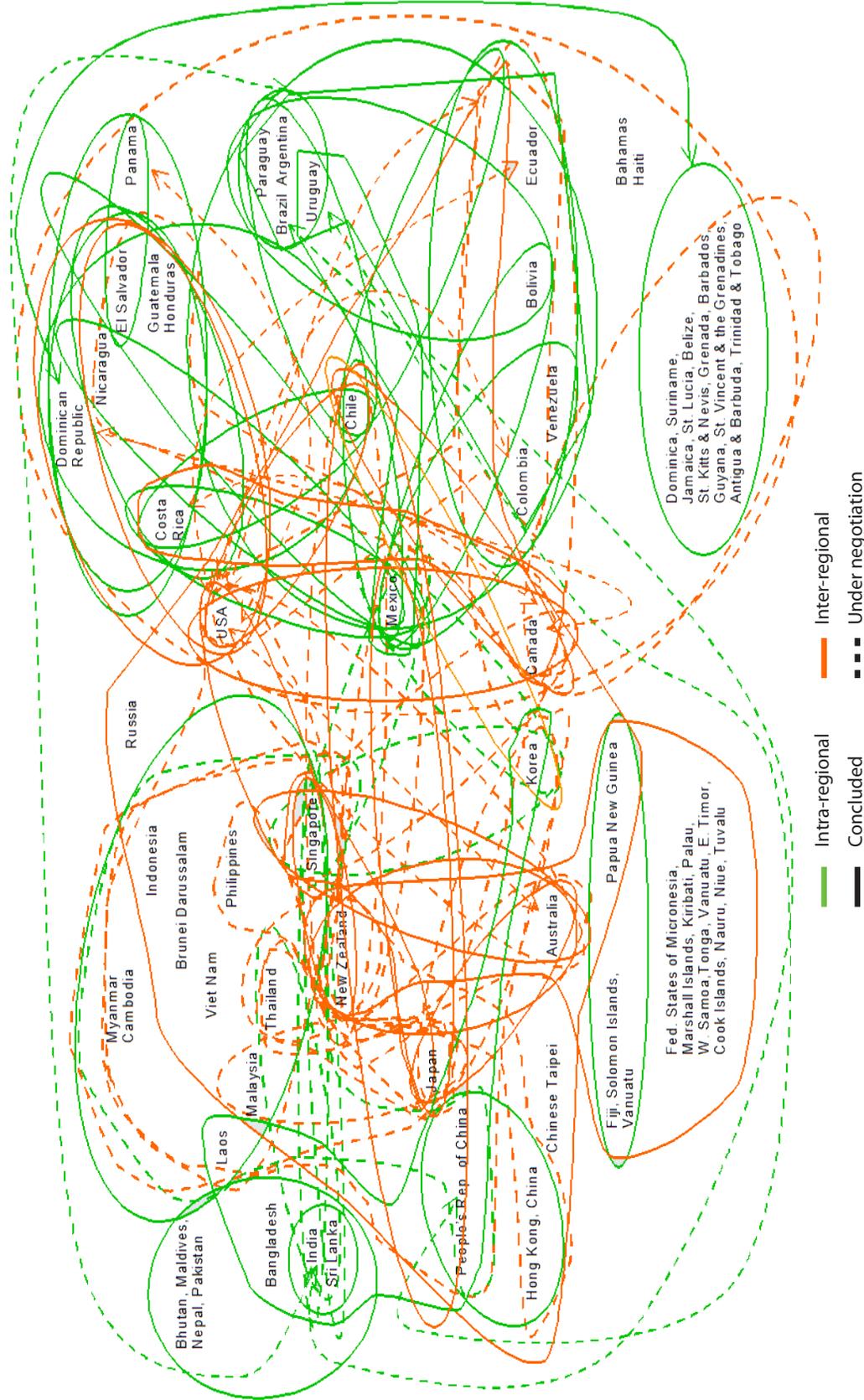
Some of Canada's interests in the TPP are also defensive. Canada risks losing the preferential access it enjoys in the United States and Mexico if its NAFTA partners are at the table while it is not. While there is no guarantee that the United States will not offer NAFTA parity to other TPP partners, Canada's presence at the negotiating table helps to ensure that the terms of the final agreement are at least consistent with NAFTA so that Canada does not have to undertake costly reforms to adapt to a new system.

One of the direct improvements that the TPP offers is the opportunity to rationalize rules of origin and simplify global trade. Rules of origin determine whether or not a product has enough locally sourced content to benefit from the preferential tariff status conferred by a particular trade agreement. Each of the circles in the **Figure 8** "noodle bowl" represents a different trade agreement. Each agreement has different customs and tariff measures that impose administrative costs of up to two to three percent of the cost of a finished product (Pastor, 2011). As such, some exporters choose not to utilize preferential tariff rates (using instead the higher WTO most-favoured-nation rates) because of the cost of tracing and administering origin. If the TPP is successful, then one trade agreement and one set of origin rules will substitute for many.

Reducing regulatory barriers

Citing studies from the Organisation for Economic Co-operation and Development and elsewhere, Michael Hart (2007) argues that regulatory divergences between trading partners add between two and 10 percent to the cost of a product. Since 2011, Canada and the United States, through the federally mandated Regulatory Cooperation Council (RCC), have made a serious commitment to durable binational regulatory alignment (Canada, n.d.). With a \$670-billion two-way trading relationship (in 2012), an improvement of even two percent would save producers and consumers more than \$13 billion annually. The framework developed under the Canada-US RCC to align regulations and phase-in periods and minimize duplication in certification and testing is likely to yield a model that could be broadened for adoption by TPP partners. If this were to occur, Canada would benefit both from greater

Figure 8: Overlapping rules of origin: the “noodle bowl” of trade agreements



Source: Inter-American Development Bank in Baier et al., 2007.

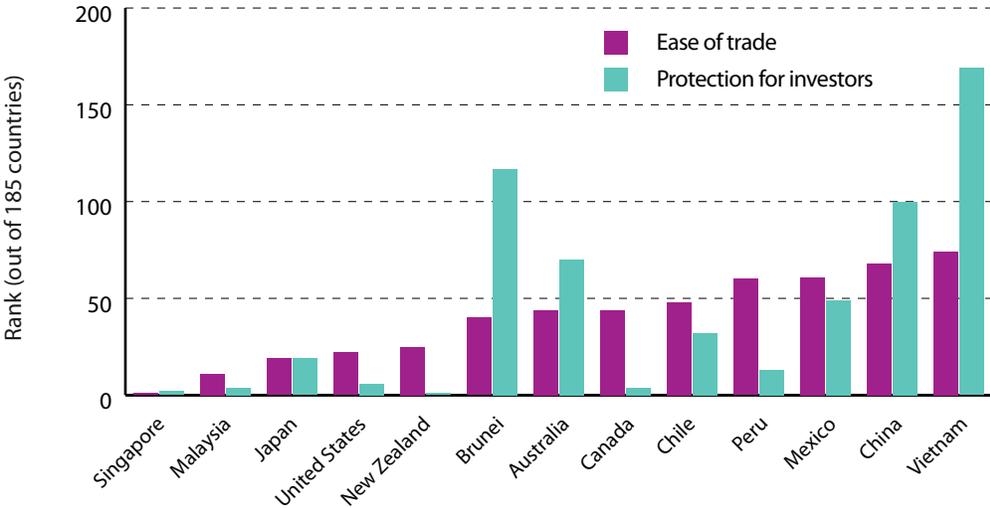
regulatory alignment with key trading partners and from being one of the authors of a system to which others adapt.

Ease of doing business

One of the biggest challenges for Canadian exporters in emerging markets is that trade and investment rules in these markets may be discriminatory, non-transparent, and inconsistently applied. The World Bank provides a relative measure of the ease of doing business in 185 countries worldwide, looking at such criteria as trade across borders and protection for investors. **Figure 9** shows that countries such as Vietnam, China, Mexico, and Peru still have significant barriers to foreign trade, though Mexico, which has had a comprehensive free trade agreement with the United States and Canada since 1994, has shown consistent improvements in its trade and investment rankings.

Agreements such as the TPP provide an opportunity for developing and developed economies to harmonize certain standards and policies. The added incentive of access to large markets such as the United States and Japan makes it more likely that developing economies will implement and maintain domestic reforms.

Figure 9: Ease of trade and protection for investors in TPP states, with China, 2012



Note: A lower number indicates a country with more business friendly regulations and protections against misuse of corporate assets.

Sources: World Bank, 2012a; 2012b.

The negotiating text of the TPP includes coverage of competition, investor protection, regulatory coherence, sanitary and phytosanitary measures, and technical barriers to trade, among other issues. It is expected that changes made through the implementation of the TPP in each member country will provide businesses with a more transparent and stable operating environment. For Canadian companies, this means that the investments they make in member countries will be subject to the stronger level of protection agreed upon in the TPP, and that the suppliers and buyers they trade with will adhere to a clear and strong set of rules in the manufacturing and processing of products. As well, all TPP members will have to ensure compliance with certain environmental and labour standards as set out in the final agreement. Taken as a whole, these new rules and standards will provide greater certainty for Canadian companies choosing to invest in or trade with TPP members, thus creating greater opportunity and lowering risk for Canadian companies operating in emerging markets.

Retail trade policy

The direct, short-term gains from trade liberalization—reduction of tariff rates—have largely been achieved through the WTO. Contemporary trade agreements grapple with non-tariff challenges—such as labour mobility, cross-border data flows, and intellectual property—and progress is slow. However, one of the enduring, long-term benefits of trade agreements is that they help to “sell” Canada and the Canadian brand to customers in new markets through the sustained presence of Canadian businesses and government officials.

The visible presence of Canadian companies and investors helps potential trading partners learn about Canadian opportunities and serves as a reminder that Canada is open for business. Trade agreements alone are an inefficient mechanism for trade promotion but, when combined with concerted market development efforts by businesses and support from government organizations such as the Trade Commissioners’ Service and Export Development Canada, these agreements provide a guarantee of Canada’s commitment and reliability to potential trading partners.

China’s possible involvement

Whether or not China will join the TPP is uncertain. Chinese leaders have only shown preliminary interest in negotiating in this forum. Since the United States is the dominant TPP player, China may prefer to negotiate through the

Regional Comprehensive Economic Partnership¹ negotiations, which include the 10 members of the Association of Southeast Asian Nations (ASEAN), plus the six countries with which ASEAN has existing free trade agreements. China is the largest economy in this group and has a greater degree of control over the pace and scope of negotiations in this forum than it would facing the United States in the TPP.

In the meantime, membership in the TPP gives Canadian businesses an opportunity to gain market knowledge and learn how to integrate into Asian supply chains, rather than competing against Asian businesses for Chinese market access. A stronger foundation in the Asia-Pacific region will help Canada to do business in the region and lay the groundwork for direct agreements with China, bilaterally or through the TPP or ASEAN frameworks.

A beneficial agreement

Seventy percent of Canada's total trade is with TPP members, but 62 percent of that trade is with the United States and only four percent involves countries with which Canada currently does not have a free trade agreement (Chen, 2013). It is clear that the TPP does not offer strong market access gains in the short term. Mostly, Canada has the defensive interest to preserve its NAFTA benefits and a long-term interest in cultivating new trade and investment partners.

However, the TPP is not going to be a costly agreement for Canada since, through NAFTA and possibly CETA, it has already made many of the reforms that the United States will be looking for from other TPP states. For example, investor-state dispute settlement (ISDS) is a challenging issue for developing countries and one that Australia is opposing (*Inside US Trade*, 2013, March 14).² Canada and Mexico have had ISDS since 1994 and it is

1. The Regional Comprehensive Economic Partnership (RCEP) is a FTA negotiation among 16 countries: the 10 members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) and the six countries with which ASEAN has existing free trade agreements (Australia, China, India, Japan, South Korea, and New Zealand). Negotiations began in late 2012. Like the TPP, negotiating parties predict that the RCEP will be "a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement establishing an open trade and investment environment in the region to facilitate the expansion of regional trade and investment and contribute to global economic growth and development" (New Zealand, Ministry of Foreign Affairs, n.d.).

2. ISDS is a provision in international trade and investment agreements that grants investors the right to initiate dispute settlement proceedings against foreign governments before an international arbitration tribunal. NAFTA Chapter 11 is an example of this provision.

now a familiar tool of commercial policy. If ISDS is adopted in the TPP, the greatest burden of reform will fall on countries with domestic systems that are less closely aligned with US commercial policy.

There has been much speculation as to whether Canada's participation in the TPP will require the dismantling of Canada's supply management system for dairy, poultry, and eggs. As Canada was negotiating entry into the talks in 2010, messaging from the United States and New Zealand indicated that Canada's dairy exceptions were keeping it out of the negotiations (see, for example, *Inside US Trade*, 2010). However, the entry of Japan into the TPP negotiations probably improves the odds for countries wishing to exempt sensitive sectors from TPP disciplines. Japan's protective policies for its domestic rice sector in the name of food security are well known and unlikely to be dismantled. As a wealthy and attractive market (currently the third largest in the world), Japan may have enough leverage in the negotiations to maintain its agricultural protections in spite of the lofty liberalization goals of the TPP. Thus, if Japanese rice protections remain, others will likely be able to shield sensitive sectors such as US sugar and Canadian dairy.

At the same time, Canada can gain from the TPP by working to shape the new rules to fit its own interests, ensuring the agreement includes, for example, standardized disciplines on trade and investment by state-owned enterprises consistent with those recently added to the Investment Canada Act, and new mechanisms to minimize "buy local" provisions in government procurement arrangements. In this sense, the TPP not only provides the opportunity to expand economic relationships in the Asia-Pacific region, but it also allows Canada to play a significant role in shaping the rules that will govern trade relationships in the twenty-first century.

Conclusion

From the 1950s to 1980s, substantial gains from trade were achieved through tariff reductions: tariffs went down, profits went up, and exports flowed through new lower-cost market access channels. But by the 1990s, the era of easy or immediate gains from trade negotiations was over. The WTO Uruguay Round reduced average industrial tariffs to under 3.8 percent in most countries; the conclusion of a new trade agreement will not yield immediate cost savings linked to tariff reductions for most participants (WTO, n.d.).

The next area of available trade gains is through the reduction of non-tariff barriers (NTBs). Gains here are more difficult to achieve because the barriers are more resistant to reform due to the complexity or newness of the issue or its political sensitivity. Reforms proceed gradually, if at all. Important non-tariff measures facing trade negotiators today include developing mutual recognition of standards and certification methods, commitments to ensure competitive behaviour by state-owned enterprises, and rules for new trading areas such as electronic commerce, third-party logistics, and the commercialization of biotechnology.

In the absence of the political will or institutional mechanisms to bring NAFTA into the twenty-first century, the TPP negotiations should help Canada to maintain its preferential trading status with the United States and provide an opportunity for it to formalize its trading relationships with new emerging market partners. Canada's sustained presence in these markets will help it to carve out niches in global supply chains and be competitive against Latin American and Asian exporters in global markets.

Even though the era of easy trade policy gains is over, the disciplines imposed by the TPP in such areas as investment, regulatory alignment, rules of origin, and market access will, in the longer term, help to increase certainty, reduce risk, and lower costs for Canadian exporters and investors in emerging markets. Finally, the TPP provides a worthwhile platform for Canada to develop new trade rules that more closely align to the realities of global commerce, while also reflecting its national interests.

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