Trading Tigers

Policy Exchange

Why the UK should embrace the free-trading nations of the Trans-Pacific Partnership

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Introduction

To ensure the UK can pursue the most advantageous trade policy post-Brexit, it will be essential to aim for the highest quality bilateral and plurilateral trading arrangements. While this may be achieved from a number of possible bilateral free trade agreements - mainly with developed countries - none offers the economic benefits the UK would derive from joining the Comprehensive and Progressive Trans Pacific Partnership (TPP for the purposes of this paper).

The UK Government has acknowledged this and set about a consultation – yet as presently formulated the Brexit White Paper places obstacles before the UK accession to TPP. The position outlined by the Government's White Paper, with trade in goods aligned to the EU, would also make it unlikely that the countries of the TPP would accept British membership. The members of the TPP are highly likely to ensure it remains a high-quality free trade agreement, meaning that it will continue to be fully comprehensive.

A services-only agreement would go against one of the core unifying principles on which TPP is founded - comprehensive liberalisation across goods as well as services and investment. While it may be possible to gain agreement for a sectoral agreement with the UK, it seems unlikely – involving as it would a step away from this fundamental principle of comprehensiveness.

Existing members like Japan, who have gone through bruising domestic political arguments to include agriculture to meet the requirement of comprehensiveness, are unlikely to be sympathetic to the UK asking for a services-only agreement. This attitude is only likely to be enhanced given the number of other countries seeking to join the TPP. South Korea would perhaps be happy to do services and leave out agriculture, however it is difficult to see how other existing members would agree to this. Many of the TPP countries are, for example, agrifood exporters - they will want to be able to export goods that do not necessarily meet the EU's restrictive regulatory requirements. If the UK is locked into EU rules, a negotiation with the TPP for a UK carve-out for agrifoods would be needed – and that would reduce the benefit of us joining for many other members.

Any future relationship between the UK and EU that fetters the flow of goods between the UK and non-EU countries substantially reduces the prospect of the UK entering into high-quality free-trade agreements with partnerships like the TPP. This should concern those who want the UK to be as open as possible to the world's fastest growing economies. In particular, many of the TPP countries are agrifood exporters and they will want to be able to export goods that don't necessarily meet the EU's very restrictive regulatory requirements. So if we were locked into EU rules we would need to negotiate a TPP carve-out for agrifood – and that would reduce the benefit of us joining for many other members.

In the years that followed the UK's accession to the Treaty of Rome economies in Asia such as South Korea, Japan, Hong Kong and Singapore took off. These dynamic economies now have some of the highest per capita incomes in the world. Other countries, furthermore, with which the UK once had close economic and trading relationships through the Commonwealth, such as Australia and New Zealand, took wealthy advanced economies that had become progressively less competitive and dynamic and disfigured through structural rigidities and embarked on radical programmes of liberal reform. The result was their transformation into some of the strongest performing advanced economies in the OECD. This story is not one that is true of the European Union – or its customs partners - over the same period.

Any restrictions on the UK's ability to engage with the TPP and the countries it represents should be considered very carefully by those concerned with Britain's future trading success and its long term economic prosperity.

What is the CPTPP?

The TPP originally included 12 countries who signed the Agreement in February 2016. Although seen as a set back to the TPP, after the US withdrawal from it, remaining members decided to continue with TPP11, which was renamed the Comprehensive and Progressive Trans Pacific Partnership Agreement (CPTPP) or TPP11.

TPP-11 is an advanced, high-quality, liberalizing, comprehensive free-trade agreement between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore and Vietnam. South Korea, Indonesia, the Philippines, Thailand and Taiwan have indicated that they wish to join soon, and Colombia has also indicated interest in joining.

Following the withdrawal of the United States, the remaining 11 members re-negotiated aspects of the TPP-12 and adopted a number of "suspensions" of certain clauses which had mainly reflected US interests. It is expected the 'suspensions" will be lifted if the US rejoins the group. The resulting agreement was signed on 8 March 2018.

So far, only Mexico and Japan have ratified the CPTPP by passing relevant national legislation to bring their domestic laws into conformance with the agreement. Most other members have indicated that their domestic legislative processes will be completed before the end of this year.

The CPTPP is a plurilateral free-trade agreement. It differs from the Single Market in that it does not have a common external tariff (that is, it is not a customs union). Individual members are free to set their external tariffs for goods from non-CPTPP members at whatever levels they wish. It also does not have a common set of regulatory standards but seeks to harmonize regulations for those standards members have agreed to include. It therefore does not involve integration at the depth of the Single Market.

CPTPP goes well beyond most other bilateral FTAs and much further than what the WTO has been able to achieve. While multilateral trade agreements in the WTO would provide the biggest gain in global economic welfare, with 186 members required to reach consensus in the negotiations it has not been possible to achieve the high standards for liberalization for market access and rule-making that the CPTPP has been able to attain.

CPTPP when fully implemented by all members will eliminate 98 per cent of tariffs among its members. Transition periods are permitted and some of these are quite long, such as removal of beef tariffs in Japan over 15 years, but all members are required to make some tariff cuts across all products when the agreement enters into force.

CPTPP has 29 chapters covering trade in goods and services, government procurement, intellectual property, investment (including investor-state provisions), transparency, and dispute settlement. Importantly, it is explicitly seen as a “living agreement” which welcomes new members and envisages subsequent rounds of negotiations to extend liberalization further among its members and keep the agreement contemporary.

The trade in services chapters of the agreement are much more extensive than in the WTOs General Agreement on Trade in Services (GATS). Specific services included in the agreement cover, among other things, financial services, professional and business services, education, transport and logistics services, health, e-commerce and telecommunications, and temporary entry of business persons. The UK with its competitive strengths in such services would be well placed to benefit from membership of CPTPP.

The CPTPP’s investment chapter contains many new rules to open member economies to inward investment and provide a range of protections to foreign investors, including minimum standards of treatment, the right to compensation in the event of certain types of expropriations, protection against discrimination, and an investor-state dispute mechanism.

For the first time in a trade agreement, the CPTPP contains anti-corruption measures relating to the bribery of public officials. These provisions will provide greater transparency and are particularly relevant to financial services and foreign direct investment.

The UK and the CPTPP

UK and TPP-11 trade flows

TPP-11 accounts for a relatively small proportion of UK trade. The table below shows 2016 statistics, the latest year for which data are available. In terms of goods and services, UK exports to TPP-11 account for 7.9% of total UK exports. The corresponding figure for imports is 6.4%. In 2016, the UK had a goods trade deficit with the TPP-11 of £3.4bn but a service sector surplus of £9bn, giving an overall trade surplus of £5.6bn.

Four TPP countries (Japan, Australia, Singapore and Canada) account for the vast majority of UK-TPP-11 trade flows: 84% of exports, 72% of imports. Of the remaining countries, the most significant in terms of exports are Malaysia (4.8%) and Mexico (4.3%) and for imports Vietnam (9.8%) and Malaysia (6.7%).

The admission of the five additional members discussed above would give a boost to the UK's share of trade with the TPP (now the TPP-16). South Korea and Taiwan would contribute most in this respect. A TPP-16 would account for around 10% of UK exports and 9% of imports (see table).

Were the US to re-join the TPP at some point then UK-TPP trade would account for a significantly greater proportion of total UK trade than it does for the current 11 members – 26% for exports and 18% for imports. If the US rejoins this larger TPP then the percentages rise to 28% and 20% respectively. These proportions are of course both significantly lower than the share of the EU in UK trade: in 2016 exports and imports with the EU were 43% and 54% of the total respectively.

Accurate and timely measures of foreign direct investment by country are not readily available. However, looking at the stock of investments held by the UK overseas and the origin of the ownership of overseas investment in the UK is possible using UNCTAD data. This shows a similar pattern to trade, with the TPP-11 accounting for 7.5% of the stock of FDI in the UK and hosting 8.5% of the UK stock of FDI. But extremely strong US-UK investment linkages would boost these ratios significantly if the US were to rejoin. The US owns almost 30% of the stock of inward investment in the UK and UK investments in the US are almost 20% of the UK total. Meanwhile the EU accounts for around 50% of the stock of both inward and outward investment.

Table 1: UK trade with current and potential TPP countries, US and EU, 2016

	Goods and services £bn		
	exports	imports	balance
Japan	12.6	11.6	1.0
Australia	8.6	4.5	4.1
Canada	8.3	7.1	1.2
Singapore	7.2	4.5	2.7
Malaysia	2.1	2.6	-0.5
Mexico	1.9	1.9	0.0
Rest of TPP	3.1	6.2	-3.1
TTP-11	43.9	38.3	5.6
South Korea	6.1	5.3	0.8
Taiwan	2.0	3.4	-1.4
Thailand	1.5	4.0	-2.5
Indonesia	1.0	1.5	-0.6
Philippines	0.5	0.9	-0.4
TPP-16	55.0	53.5	1.5
US	100.5	67.3	33.2
EU	240.7	320.4	-79.7
Total	554.7	595.4	-40.7

%			
TPP-11/Total	7.9	6.4	
TPP-16/Total	9.9	9.0	
TPP-11+US/Total	26.0	17.7	
TPP-16+US/Total	28.0	20.3	
EU/Total	43.4	53.8	

Source: ONS, UNComtrad

Of course, there is no credible claim that UK membership of the TPP-11 would replace its trading relationship with the EU. The share of the EU in UK trade is likely to continue on a downward trend in coming years, although it will clearly remain a more important trading bloc for the UK than the TPP-11 for the foreseeable future.

It is very likely, however, that TPP-11 will enjoy faster GDP growth than the EU in the coming years and therefore in all probability in trade flows too. Thus marginal growth in UK trade may well come from faster growing developing economies, such as some members of the TPP-11.

We have made an approximation of the long-run trend rate of GDP growth of TPP-11 as a whole (using $ nominal GDP to calculate country weights). Our estimate is that TPP-11 has a trend rate of GDP growth of 2% a year. This result is heavily and negatively influenced by Japan's membership: Japan has a 46.5% GDP weight in TPP and a very low trend rate of growth due largely to its rapidly aging population. (Note that a TPP excluding Japan would have a trend rate of growth closer to 3% a year.) But even a 2% a year TPP trend rate of growth is higher than the corresponding rate in the EU, which is around 1% - again due to demographics - and also poor productivity growth.

Analysis by the Washington-based Peterson Institute (October 2017) found that adding the five Asian economies (Indonesia, South Korea, Thailand, Philippines and Taiwan) that have already expressed interest in joining would more than offset the loss of welfare gains from the US's departure.

Even without US membership, TPP-11 remains the single biggest free-trade group outside the EU. For the UK, with a strongly based services economy and where investment flows are of major importance, TPP-11 offers greater market access and stronger rules for investment than what is available under the WTO.

Membership of TPP-11 for the UK should be relatively straight forward to negotiate in view of the existing openness of the UK economy. It may also obviate the need to rapidly conduct several bilateral FTAs in parallel following BREXIT as well as the big demand for negotiating resources that doing so would entail. Membership of TPP-11 would give the UK largely unrestricted access to other members' markets, including markets such as Japan's for agricultural products.

It is unlikely that the UK would be able to negotiate on a bilateral basis materially better FTAs with individual TPP-11 members than it could with the TPP-11 group as a whole. It is useful to think of the UK's joining TPP-11 as effectively negotiating a "package" of 11 FTAs simultaneously.

The Geopolitics of CPTPP

Following President Trump's decision to withdraw the US from the TPP, members are keen to attract new participants to increase the economic benefits of membership. This is particularly the case for members such as Japan, for whom being in the grouping with the US and having greater access to the US market was particularly important.

As TPP-11's biggest economy, Japan would find UK membership particularly attractive as it would increase the size of the group and hence the potential benefits for Japan. Membership might also help mitigate any potential adverse effects on Japanese FDI into the UK following Brexit.

When former President Obama elevated the TPP to a major policy priority for the US, his Administration also had broader geo-political objectives in mind. Even though the TPP is based on the principle of "open membership", TPP was seen as a grouping that collectively could help balance China in the region. The openness required of members, including in traditional "sensitive" sectors such as agriculture, together with rules intended to open sectors such as financial services, rules on investment and on intellectual property meant that China would not be prepared to join. With the US in and China out, the TPP was particularly attractive to Japan and so Prime Minister Abe was prepared to spend political capital on membership, even involving some opening of Japan's heavily protected agricultural sector.

For the US, the geopolitical dimensions of TPP membership remain as compelling as ever. Regardless of the economic benefits of the TPP for the US, pressure is likely to continue from within the US and its allies in the Asia-Pacific region for the US to return to the TPP. Both Hilary Clinton and Trump as candidates opposed TPP membership during the 2016 campaign, but it is not out of the question that the US will seek to re-join, even under Trump. Of course, if the US is in again it would substantially increase the benefits for the UK of membership.

UK membership would be attractive to Japan in view of the substantial Japanese investment flows to the UK and the addition of a sizeable market. It would add an additional developed economy capable of taking on high-level commitments in investment, services and a relatively liberal regulatory regime.

UK membership may also encourage the US to reconsider its position. Withdrawing is seen in Washington as costing the US in terms of potential benefits forgone and, more immediately, the loss of markets to the US's competitors. This will be felt most keenly in the politically sensitive area of agriculture. The US has also lost influence in the Asia Pacific region by withdrawing and, while China is not a member of CPTPP, it welcomes TPP11 over TPP12 and the added influence it would give the China? in the region through its failure to more closely align regional economies with that of the US. The UK's joining CPTPP would recharge domestic debate in the US over the costs of leaving.

The UK's joining would further increase the gains from having a bigger group. As conventional economic theory would predict, the Peterson Institute's modelling confirmed that "bigger is better" in terms of potential benefits from the free-trade agreement, but also that "better is best" in terms of the breadth and depth of the agreements coverage. The UK's joining would add both to TPP's size and quality.