Mega Regional Trade Agreements: How Excluded Countries can Meet the Challenge

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Abstract: The mega regional trade agreements – the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), the Regional Comprehensive Economic Partnership (RCEP), and the Trade in Services Agreement (TISA) – will impact on non-parties through a combination of trade and investment diversion and the spillover effects from the emerging regulatory framework for global commerce that these agreements will effectively put in place. Excluded countries need to take preparatory measures to address these looming impacts. This paper expands upon a previous paper by the authors[1] and reviews the changes to the regulation of international commerce that will be brought about by the mega regional trade agreements both directly between the parties to those agreements and indirectly to third parties through spillover effects. Based on this review, it develops options for policy responses by those nations who are not members of the mega regional agreements.

Keywords: mega regional trade agreements, trade rules, non-tariff measures, regulatory compliance

JEL Codes: F15, L52, O25

[1] Dan Ciuriak and Harsha Vardhana Singh, 2015, "Mega-regionals and the Regulation of Trade: Implications for Industrial Policy", International Centre for Trade and Sustainable Development and World Economic Forum E15 Expert Group on Reinvigorating Manufacturing: New Industrial Policy and the Trade System, March 2015, http://e15initiative.org/publications/mega-regionals-and-the-regulation-of-trade-implications-for-industrial-policy/

1. Introduction

The mega regional negotiations include the 12-member Trans-Pacific Partnership (TPP), the EU-US Transatlantic Trade and Investment Partnership (TTIP), the 16-member Regional Comprehensive Economic Partnership (RCEP), and the 24-member Trade in Services Agreement (TISA), a sectoral agreement being negotiated under Article V of the General Agreement on Trade in Services (GATS). These agreements, and others negotiated in their shadow and aligning their rules accordingly, cover a critical mass of global commerce and include the world's major economic hubs and regulatory pace setters. Parties which are not members of the agreements will be impacted by trade and investment diversion and by spillover effects related to changes in market access conditions under the regulatory framework for global commerce that these agreements will effectively put in place. The spillovers will be particularly felt in terms of the emergence of new substantive horizontal and sectoral standards, including private sector standards, and in the emergence of new norms as regards institutional and procedural approaches to domestic regulatory policy formation.

The alignment of standards within these major trading blocs will have some positive spillover effects on third parties – for example, by enabling products certified for one market to serve both, where currently dual certifications are required (Cernat and Sousa, 2014; Kox and Lejour (2006). While on the one hand, excluded parties will retain greater policy space which may be advantageous for development purposes, on the other hand loss of market access and difficulty of linking up with large parts of global trade and investment covered by these mega regionals would create difficulties for that development process.

Such difficulties will be compounded compliance requirements with the new and likely higher standards, which will involve new costs and new investments for excluded parties. Similarly, tighter disciplines on trade-restrictive and investment-restrictive policies within the mega regional markets generate competitive benefits for firms from those within these markets as well as potential market access barriers for firms in excluded parties.

The balance of positive and negative spillover effects is an open issue. Some studies (e.g., CEPR, 2013) find net benefits; some find net costs (e.g., Ciuriak and Xiao, forthcoming; Narayanan, Ciuriak and Singh, forthcoming). Ultimately, the outcome for individual countries may depend on whether they take prudent preparatory measures. This note considers preparatory measures and other responses that excluded parties will have to consider to limit negative spillovers and take advantage of positive spillovers of the mega regionals.

We first review the changes to the regulation of international trade that will be brought about by the mega regional trade agreements both directly between the parties to those agreements and indirectly to third parties through network and demonstration effects. We focus on the TPP because of its centrality and its scale. As regards the TPP's centrality, it sits at the cross-section of the TIIP (the United States is half of TTIP), of RCEP (7 of the 16 RCEP members are currently TPP members and Korea has formally applied for membership), ASEAN (four ASEAN members participate in the TPP), and the TISA (8 of the 24 TISA members are also TPP members). As regards its scale, the TPP covers about 30 per cent of world trade. Thus, it already has a critical mass and is poised to grow still larger, having emerged in the context of the Asia Pacific Economic Cooperation (APEC) forum's efforts to develop a Free Trade Area of the Asia Pacific (FTAAP; see e.g., Petri et al., 2012). Taiwan, which is already a party to the TISA talks, has launched an advocacy campaign to promote its TPP accession aspirations (Dawson and Ciuriak, 2014a and b). Several other APEC members, including Thailand and the Philippines, as well as non-APEC Pacific Rim countries (Costa Rica and Colombia) have also expressed interest. Accordingly, the TPP is likely to grow and increasingly to drive change in the regulation of global commerce. By the same token, it stands as a good proxy for the effects of the mega regionals as a whole.

Based on this review, we develop options for policy responses by the excluded parties. The rest of the note is organized as follows. Section 2 elaborates the ways that the TPP will impact on excluded parties; as noted, this stands as a proxy for the effect of the mega regionals in general. Section 3 develops options for responses by the excluded parties to limit the extent of negative spillovers. Section 4 concludes.

2. The Impact of the Mega Regionals on the Regulation of Trade and Investment

1.1. Assessments of the overall economic impact of the Mega Regionals

Conventional economic modelling indicates moderate positive income and welfare gains for those inside the tent and generally small negative losses for excluded parties. One study on TTIP specifically builds in positive spillover effects for excluded parties from regulatory convergence and accordingly finds gains for the excluded parties. However, the cost of compliance with new standards is not a factor that has been included in studies to date; accordingly, as yet, the picture on the impact of the mega regionals on excluded parties must be considered to be incomplete. Furthermore, while the overall impact of tariff reduction appears to be small, for specific sectors the impact could be high. Table 1 provides a representative sample of study results. TISA modelling results have yet to be posted in the public domain. Table 2 shows the average tariffs for US and EU.

Table 1: Mega Regional Impacts on Parties and Non-Parties, Selected Studies

Study	Gains for Parties	Impact on Excluded Parties
TPP12		
Petri, Plummer and Zhai (2012)	0.8% GDP gain	-0.037% GDP loss
Cheong (2013)	0.11% GDP gain (0.28% excluding the US, which registers a zero gain)	-0.07% (ROW) to -0.11% (Korea and China), including India at -0.05%
Lee and Itakura (2013)	0.28% GDP (at 2020 for TPP Track A)	Approximately -0.01% (including India at -0.01%)
Kawasaki (2014)	0.4% income gain (tariffs only) rising to 1.8% income including NTM reduction	Negative income impacts for almost all excluded parties reported; negative effects are typically larger for the scenario with NTMs; India is impacted -0.2% in both scenarios.
Ciuriak and Xiao (2014)	0.24% GDP gain	-0.04% (ROW) to -0.11% (Korea) GDP loss, including India at -0.07%
TTIP		
ECORYS (2009)	0.7% GDP gain for EU and 0.3% gain for US in ambitious scenario	No impacts reported
CEPR (2013)	0.48% GDP gain for EU and 0.39% gain for US in ambitious scenario	0.14% positive impact on third countries due to positive spillover assumption of 1/5th the size of the regulatory harmonization gain for the EU and US

CEPII (2013)	0.3% GDP gain for both the EU and US	No impacts reported
RCEP		
Petri Plummer and Zhai (2015)	1.92% GDP gain for RCEP parties combined; India's gain is 4.3%	-0.19% loss for third parties, including a loss of -0.09% of the US and -0.05%, for the EU;
ASEAN Economic Community		
Petri and Plummer (2014)	5.3% GDP gain	-0.04% GDP loss for third parties,

Notes:

1. Cheong (2013) does not report the aggregate results for the TPP12; the figures cited are based on reported impacts on the individual TPP12 economies weighted by their projected GDPs in 2016.
2. Lee and Itakura (2013) do not report a TPP12; the figure given is based on reported impacts in 2020 on the individual TPP12 economies weighted by their projected GDPs in 2016.

Table 2. MFN and Peak Applied Tariffs in Selected Product Categories for EU and US (%)

Product Category	EU Average Tariff	EU Peak Tariff	US Average Tariff	US Peak Tariff
Wood, Paper, etc.	1.0	12	0.5	16
Textiles	6.6	12	7.9	34
Clothing	11.5	12	11.6	32
Leather, Footwear, etc.	4.2	17	3.7	60
Non-Electrical Machinery	1.9	10	1.2	10
Electrical Machinery	2.8	14	1.4	15
Transport equipment	4.3	22	2.3	25
Manufactures, n.e.s.	2.6	14	2.2	39

Source: WTO.

1.2. Spillover Effects of TPP Measures on Excluded Parties: General Considerations

An important question to confront at the outset is the extent to which we can anticipate the content of the regulatory framework that will emerge from the TPP, which as noted above is the main focus of our discussion. In this regard, an important feature, and even criticism, of the ongoing mega regional negotiations is that they are being conducted in secrecy. However, notwithstanding the secrecy that surrounds the negotiations in the mega regionals, much of the likely content and the change in trade regulation can be assessed with a reasonably high degree of confidence.

Generally speaking, the substantive regulation of international commerce is not developed in such negotiations but rather in a plethora of international fora that are transparent and involve experts, corporations and public officials from a wide range of interested parties. Moreover, as the art of writing subject-matter chapters (e.g., for e-commerce or financial services) develops, the language tends to become standardized, as examination of the relevant chapters in a series of recent agreements will show.

The role of these trade agreements is accordingly primarily to promote adoption of emerging standards and recommended practices – although obviously part of the negotiation involves horse-trading that inevitably affects commercial interests, with some interested parties winning and some losing, hence the tight-lipped confidentiality of the process. In many areas, the controversial element is whether some of the constraints on public policy that are demanded by the major negotiating parties are beneficial or detrimental to developing economies (e.g., the intellectual property provisions and the constraints on state-owned enterprises).

Usually, assessment of trade agreements focuses on the direct effects of trade disciplines. However, the policy framework that is shaped by these disciplines will also have consequential effects on the evolution of markets. These effects are highly relevant for policymakers and business interests in non-member states. Two important such effects flowing from the TPP – which are mutually related – would be to fragment global markets and to generate TPP-oriented value chains. The preferential conditions established by the TPP – through lower tariffs, similar standards and rules of origin favouring TPP producers – will not only lower barriers to trade within the TPP region but will tend to segment the TPP market from the rest of the world. This will in effect create conditions for generating TPP-oriented value chains, similar to ASEAN value chains in that economic region.

A key feature of value chains is the prominence of the lead firms that organize them – i.e., the firms at the hub of the value chain structures. Since the US is the leading economy in the TPP, accounting for about 60 per cent of economic output amongst TPP nations, most TPP value chains will revolve around US multinationals. These lead firms specify the standard that will prevail through different parts of the chain. These are private standards and often are higher and more exacting than mandatory standards imposed by public regulations. One reason of course is product quality: leading global firms have brand name reputations at stake. Companies also respond to activist Boards of Directors and consumer movements in respect of a wide variety of standards, some related to product safety and quality,[2] but others to concerns such as environmental impacts and social concerns.[3] Brand-name manufacturers and retailers, who are closest to end users, are particularly susceptible to these latter pressures.

Standards evolve over time reflecting the changing emphasis of value systems in the hub. California, for example, which is often in the vanguard in driving standards (hence the well-known "California Effect"[4]), has

[2] See Makower et al. (2014) for a discussion of consumer pressure on companies such as Campbell's Soup and General Mills to eliminate use of bisphenol A, an industrial chemical used in hard plastic and metal-based food and beverage containers.

[3] See Ciuriak and Ciuriak (2013) for a discussion of this issue in the context of climate change responses.

[4] The term "California effect" was coined to reflect the adoption by US auto manufacturers of California's motor vehicle emission standards as de facto US standards because of the size of the California market. Through this effect, large economies may raise business costs in third markets: because firms cannot afford to lose their key markets, they adopt the higher standards, which then become de facto standards for all their markets. See, Vogel (2000) for a fuller discussion of this effect. Another dynamic, which was seen with the EU's REACH regulation on chemical use involves multinational firms lobbying intensely against the higher standards but then using them to competitive advantage against smaller rivals once they are passed. For a recent discussion of this area, see Carruthers and Lamoreaux (2014).

recently adopted a Green Chemistry Initiative, to identify and restrict toxic chemicals in consumer products sold in the state: “The law requires a new life-cycle “alternatives analysis” to evaluate suitable substitutes for hazardous substances in consumer products, based not only upon their risk during product use but also during their manufacture and after disposal. The state may then condition, restrict or ban the use of those chemicals.” (Makower et al., 2014; 12). It is noteworthy that President Obama has said that, through TPP and TTIP, he wants to implement the US value system in trade conditions. In this year's Report of the U.S. President's Economic Council, he says, "new trade agreements would help American businesses reach new markets and put stronger environmental and labor standards in place, to ensure that all countries are playing by the same, fair set of rules. The trade deals that my Administration is negotiating in the Atlantic and the Pacific regions would do just that" (The White House, 2015; at 5). Likewise, he wrote a blog stating that, "Right now, China wants to write the rules for commerce in Asia. If it succeeds, our competitors would be free to ignore basic environmental and labor standards, giving them an unfair advantage over American workers" (Obama, 2015).

Thus, both private firms and the US public sector are focusing on similar kind of concerns, which in turn will be reflected in the standards developed within the US and promoted through the TPP. Firms within the TPP region will have to move towards these standards, given the key economic position of the US in the trade agreement. Firms from outside the TPP region will also feel pressure to meet these standards, in order to preserve their access to the massive TPP market. And, since value chains are not limited only to the TPP producers, the impact of these standards will thus extend beyond the TPP region as well, especially given the role of US firms as lead firms in such chains.

The mega regionals will tend to favour established firms and their business models. To be sure, business opportunities arising from ongoing trade and investment growth will continue to provide the possibility for new large firms based in developing countries to establish themselves on the global stage[5], and will continue to allow for rapid growth prospects for a large number of developing economies through commercial links with different large markets in the world[6]. The mega regionals themselves will also result in new market opportunities albeit in a fragmented manner where preferential access is provided to members and relative benefits of access are lower for non-members.

Nonetheless, existing large firms, particularly those from the mega regional markets, will have an advantage in the emerging conditions for global trade and investment, for several reasons:

- their ability to realize increasing returns to scale in many sectors, which the mega regionals will promote by expanding preferential market access;
- the natural hedges that global production and global sales provide against exchange rate volatility – the mega regionals are unlikely to work to constrain exchange rate volatility;
- the advantages that capital mobility provide in minimizing tax burdens, including through advantageous transfer pricing; leverage on destination countries for more favourable terms than afforded local companies;

[5] See for example, McKinsey 2014, 13, exhibit 7 for assessment about companies from emerging markets such as China being able to have a significant share of the Global Fortune 500 companies.

[6] See for example the concept of N11 or MIST coined by Goldman Sachs. (http://www.bloomberg.com/news/articles/2012-08-07/goldman-sachs-s-mist-topping-brics-as-smaller-markets-outperform)

- restrictive rules of origin in preferential trade agreements that favour large shipments, and thus larger established companies;
- access to trusted trader programs, which is relatively expensive for SMEs and thus tends to favour larger established companies; and
- more demanding compliance requirements and procedures as standards become generally increasingly more sophisticated, consistent with the more advanced capabilities in the most advanced countries which are driving policy in the TPP and TTIP

For countries like the Philippines, Thailand, and Indonesia, which have not yet climbed the technology ladder, and have yet to spawn their share of global giants, the emerging mega regional-driven rules-based framework and the conditions specified by lead firms in value chains in western markets may thus impose onerous market conditions, which they would have to address through policies to mitigate the adverse effects.

1.3. Impact of TPP Disciplines on TPP and other Markets: Specific Aspects

Based on available information, including the published texts of trade agreements that were negotiated concurrently by TPP parties, leaked texts, and official commentaries on the progress of the negotiations, and building on the review of the likely impact of the mega regionals on industrial policy in general conducted by Ciuriak and Singh (2015), we consider below the spillover effects of the mega regionals on excluded parties.

We first consider, in summary form, the implications of TPP standards in terms of those areas of trade disciplines which will have a strong effect on market conditions and otherwise. Subsequently, we look in more detail at the impact of each of the different disciplines arising from TPP. This will help us also to determine the implications for response of non-members to the emerging disciplines from TPP. Annex 1 contains the detailed derivation and explanation.

One aspect which is not covered in the Table is that, for firms within the mega regional agreement, there will be several conditions created which will lead to improving their competitive position both within the region and in global markets. Another feature is that there will be two types of positive implications for non-members. One is greater policy space by not being part of a deal with higher disciplines or standards. Second would be benefit from those "good governance" policies such as greater transparency etc., which would be available in a general manner to all parties, whether or not they are members.

However, as we discuss below, these benefits to non-members are not unequivocal: a flip side to more policy space, for example, will be that exports from non-members may face erosion/exclusion of access to TPP markets unless they meet the relevant conditions which underlying loss of policy space. More detail on these aspects is provided below in Annex 1, which gives a comprehensive picture of the situation.

Table 3: TPP Regulatory Implications by Type and Strength of Influence over Non-Members

Measures discriminating in favour of TPP members: ▪ Preferential tariff reductions ▪ Services liberalization ▪ Rules of Origin ▪ Customs administration ▪ Government procurement ▪ Investment pre-and post-establishment rules	**Trade/investment diversion away from non-members. Encouragement to value chains formed with producers within the FTA zone.**
Subject areas with strong implications for market conditions faced by non-members	Nature of impact on the market
Measures to be applied in general, and members meeting them under the agreement: ▪ Data transfer ▪ Privacy rules ▪ Intellectual property rules ▪ Competition Policy ▪ State-owned enterprises, ▪ Labour and environment measures	New limits on access of non-members to mega-regional markets unless conditions are met. Over time, firms based in the mega regional parties may demand that some of these conditions (e.g., IPRs) be applicable for their investment in non-members economies. Labour and environment concerns will also generate more private standards incorporating stricter conditions; these will increasingly dovetail with mandatory public standards, creating additional market access costs.
Subject areas with strong implications for market conditions faced by non-members	Nature of impact on the market
Multilateralization of Rules: ▪ Technical barriers to trade ▪ Sanitary and phytosanitary standards ▪ Mutual recognition	TPP members joint efforts in developing standards or taking positions in multilateral Bodies relating to standards

Source: developed by the authors.

Distilling the analysis, we infer the following:

1) The mega regionals are more constraining to those inside the deals, leaving greater policy space to those outside.

2) However, this additional policy space comes with costs: competitive disadvantage in accessing the mega regional markets and value chains within the region covered by those agreements, and additional costs in upgrading standards without a voice in formulating these standards.

3) The constraints are likely to be dynamic and to keep evolving over time; this reflects a key feature of the approach in the mega regionals, which is to put in place mechanisms for regulatory cooperation on an ongoing basis to harmonize regulations and/or to develop mutual recognition agreements.

4) The role of private firms in developing standards will expand, driven by market competition and facilitated by their participation in consultative mechanisms created by the mega regionals. The evolving dynamic is most likely going to be the strongest in new areas such as the digital economy.

5) How the parties to the mega regionals pursue their regulatory cooperation will be of great importance for excluded parties. A focus on harmonization of product standards can generate positive spillovers. A focus on MRAs, however, can make the de facto harmonization or equivalence exclusive to the parties within the agreements. Since the MRA route is the most likely (being the least intensive in terms of

domestic legal reforms), excluded parties are likely to experience less in the way of positive spillovers and more in the way of additional cost disadvantage in competing for mega regional market share.

6) In some areas, the constraints will hit hardest on the parties to the agreements themselves; excluded parties will retain greater policy space and will be in a position to pursue competitive advantage in niche areas – e.g., generic medicines and derivative innovations. This may, however, come with limits on ability to sell into markets covered by mega regional agreements, diminishing the value of this policy space.

7) For emerging markets with aspirations to join mega regionals, the opportunity cost of not accepting these constraints is significant through trade diversion and potential preference erosion in the major markets.

8) For most lower-income developing countries, the restrictions of accepting the higher standards or disciplines of TPP are not likely to bite hard as their prospects for joining a mega regional are slim and they will continue to be able to selectively use policies to encourage value addition through first-stage processing downstream from basic agriculture, fishing, forestry and mineral sectors and similar other policies.

9) In a similar vein, the mega regionals are likely to favour certain innovation models over others: the pharmaceutical package restrains re-innovation in pharmaceuticals, as it delays and raises the costs of introducing generics; copyright extension impedes derivative innovation; and digital rights management is not aligned with open-source/community-based innovation models, which involve many small players making cumulative and often "grain-sized" innovations. For excluded parties, this provides both competitive opportunities, and the potential cost of limited access to mega regional markets.

10) The mega regionals will also open up competitive opportunities to excluded parties to use the developmental role of the state. The main immediate effect of new rules governing SOEs will hit hardest the parties to the agreements themselves. However, this too could have a linked constraint on commercial activities involving TPP countries.

11) As the mega regional zone grows through accession, the value of additional policy space to excluded parties will shrink. This dynamic feature needs to be carefully weighed by excluded parties in terms of adopting strategies to meet the challenge of the mega regionals.

3. How Excluded Parties can meet the Mega Regional Challenge

We next suggest a number of strategies that excluded parties can use to meet the competitive challenge posed by the mega regionals in terms of trade and investment diversion and in raising regulatory compliance costs. Table 4 categorizes the types of responses conceptually.

Table 4. Responses to the Standards Challenge Posed by the TPP

Type of response	Example
Non-members' domestic policy response	▪ Improve domestic policy frameworks competitively to strengthen internal economic dynamism.
Trade policy response of non-members with other nation(s) which are members of mega regionals	▪ Free Trade Agreements with major mega-regional partners (e.g. India-EU); or, Investment Agreement (e.g. India-US).

Seek to influence mega regional outcomes to minimize negative spillovers	▪ Lobby mega regional partners for flexible and inclusive approach, especially in terms of capacity building for low income economies to meet higher standards by facilitating conformity assessment for standards ▪ Promote mega regional adoption of more multilateral solutions (e.g., rules harmonization rather than the more exclusionary MRAs)
Collective response by non-members	▪ South-South FTAs, with specific focus on Rules of Origin that promote SME utilization of FTAs ▪ To work with each other to help with capacity upgrades to meet the relevant standards
Response by mega regional partners themselves	▪ Consider inclusive approaches, including opening up consultative mechanisms on rules to non-members and given weight to the ideas proposed by groups of non-members ▪ Work with private sector lead firms in value chains to build platforms that would make these standards more coherent and less distinct from each other

Source: Developed by the authors.

Below we sketch out in more detail several particular responses. We would characterize these as "conversation starters" – to jump start what we perceive to be a necessary dialogue amongst many parties at many levels to ensure that the global welfare outcomes of the mega regional wave are optimized.

First, support an ambitious conclusion to the Doha Round. The WTO is a more inclusive place for non-member countries than the mega regionals. The mega regionals emerged in good measure due to the absence of progress at the WTO; ways should be considered to take forward the WTO agenda to develop disciplines that would be more sensitive of the concerns of non-member developing countries. The WTO TFA was an important step in this direction; rapid implementation of the agreement naturally works to neutralize competitive and diversionary effects of the mega regionals on third parties in the area of customs procedures. A coalition of the willing and excluded needs to be formed. A previous example of this in the context of the Doha Round is the stimulating discussions under the Oslo Group[7], which restarted the process stalled in 2006. The aim has to be to come up with processes and methods to incrementally move the initiative from mega regionals to more multilateral solutions.[8] No better time than with the 10th Ministerial and the 20th Anniversary of the WTO at hand.

Second, make a virtue of necessity and improve domestic policy frameworks to be more responsive and build business capacity to become more adept to meeting higher domestic standards (and in the case of regional groupings through regional cooperation). There is much evidence that high standards promote competitiveness, in part by driving out weak domestic firms, which frees up market share for stronger

[7] The so-called "Oslo group" comprised Canada, Chile, Indonesia, Kenya, New Zealand and Norway. See https://www.wto.org/english/thewto_e/whatis_e/tif_e/org3_e.htm

[8] For some ideas, see for instance Harsha Vardhana Singh, 2014, "WTO Agriculture Negotiations: The Way Ahead", in Ricardo Melendez-Ortiz, Christophe Bellmann and Jonathan Hepburn (eds.) Tackling agriculture in the Post-Bali Context: A collection of short essays, ICTSD e-book, 27th November 2014.

domestic firms. Raising standards can have the same effect in terms of driving domestic market consolidation as pro-active industrial policy, but in a way that cannot be challenged under the trade rules being promoted by the mega regionals. Further, raising domestic standards generates much the same "creative destruction" in terms of domestic market re-organization as does trade liberalization – but with the possibility of market share gains going primarily to other domestic firms. The external threat posed by the mega regionals can be used to leverage domestic support to counter vested interests that would be opposed. This is more complicated in the case of regional groupings since not all members of the regional grouping are assured benefits; in such cases, the policy would have to be complemented with mutual regional assistance for capacity augmentation.

Third, go with the flow in terms of making use of the industrial policies that the mega regionals leave open. Ciuriak and Singh (2015) identify four major industrial policy approaches that the mega regionals leave open:

1) the traditional horizontal agenda,
2) governments coordinating private sector energies to achieve a consensus vision,
3) building capacity to address the emerging and more challenging global rules regime and market requirements, and
4) the role of the government as an investor.

Note that the use of high domestic standards to drive industrial restructuring strongly complements the third industrial policy option listed above. Importantly, diversification is growing in acceptance as a legitimate policy objective, although it is still usually articulated in the language of specialization – i.e., in terms of developing areas of latent or future comparative advantage. But some analysts have openly challenged this articulation. For example, Ricardo Hausmann calls out the "specialization myth" and argues for complexification of systems, within which individual agents are able to specialize (Hausmann, 2013; Hausmann et al., 2013). Acceptance of diversification as a legitimate aim of policy is an important step to "normalizing" industrial policy (to use Dani Rodrik's 2008 term). Addressing mega regional implications in terms of the interaction between WTO rules and industrial policy represents an important opportunity to establish a positive articulation of diversification as a legitimate policy goal and to identify WTO rules that need to be amended to recognize its legitimacy.

Fourth, use the evidence of negative impacts on third parties from the mega regionals to promote a public campaign in favour of "responsible regionalism" that involves inclusive provisions in cooperation chapters, such that these work not just for negatively impacted parties within the mega regionals but also for negatively impacted excluded parties. For example, TPP parties' could automatically extend conformity assessment recognition to non-parties that achieve recognition in at least one TPP member state (Fricke et al., 2015).

Fifth, develop a step-wise strategy to move towards the higher standards encompassed in mega regionals, especially because a large part of global markets may follow those standards. One possible such step could be having FTAs with some of the large economies. Another could be to develop a base by considering an investment agreement with one of the large economies.

Sixth, develop active dialogue with key lead firms in large economies in selected value chains to simplify private standards or work towards making them more coherent and less diverse. In this context, efforts such as those under the United Nations Forum on Sustainability Standards (UNFSS) could also be built further and strengthened in terms of scope, content and participation of the private sector.

Seventh, focus on advantages which can be reaped through intellectual property regimes. Developing countries control the tropics and the tropics control the world's major store of genetic information. A "Developing Countries United" pact for TRIPS+ standards of protection for traditional knowledge and use of indigenous biological information in pharmaceuticals, if supported by a critical mass of developing countries, including importantly the BRICS, would serve as a major industrial policy to drive innovation and development in the developing countries – and extract royalty payments from the Triad group that currently control pharmaceutical production. It would be worth considering that, if geographical indications can be retroactively restored, ownership of indigenous biological material May also be treated in a similar manner.

Eighth, neutralize the negative impact of rules of origin on excluded parties. This would involve, in the first instance, establishing a model for rules of origin in south-south trade agreements that takes into account the fixed costs of compliance by incorporating a lower threshold for regional value content and a higher de minimis threshold in terms of duty payable on individual shipments for compliance with rules of origin certification (Ciuriak, Melin and Bienen, 2015). These rules could also consider some threshold levels for low income economies which may give them a status similar to those qualifying for being part of the rules of origin.

4. Concluding Comments

The mega regionals introduce important new tensions into the global trading system. In particular, the mega regionals will likely work to constrain the degrees of freedom for policy in several ways, principally in terms of limiting the use of border measures, limiting the scope for technology acquisition, limiting the role of SOEs, and limiting the scope for policy-led development of the digital economy through localization of data processing. In another dynamic, the mega regionals will raise the bar in terms of compliance with the rising and changing standards of the global trading regime, requiring additional pro-active engagement of governments to help their economies cope.

In terms of rules, the role of the mega regionals will not be so much in terms of developing new technical substantive content, as in promulgating the substantive content being developed by other organizations, such as the World Customs Organization and the OECD. At the same time, endorsement of particular models put forward in these other organizations may tip the balance on still-open decisions.

As regards standards, private standards in such areas as sustainability and labour adopted in TPP and TTIP countries will raise the bar for firms in developing countries that are not parties to these agreements. This in turn will generate requirements for greater industrial policy support from developing country governments to enable their firms to participate in global value chains. The procedural standards established by the mega regionals, meanwhile, will influence which standards become internationally adopted. In the latter regard, the access afforded to private sector participation in rule-making will be largely taken up, even more than currently is the case, by established firm based mainly in advanced countries.

The mega regionals will have the least restrictive impact on the most advanced countries. This is because these agreements internationalize the existing advanced country governance model. This model does not prevent rivalry to capture the new technology sectors through public support for R&D and levelling the international playing field in terms of cost of production. Indeed, the mega regionals may be seen as one plank in the cost-levelling strategy, with the central aim of raising costs in emerging markets by imposing developed country procedural standards and/or disciplines, while advanced countries themselves seek to reduce costs – including interestingly by relaxing some environmental initiatives on competitiveness grounds (e.g., the recent repeal of Australia's carbon tax). However, even in advanced countries, some of the emerging disciplines will raise innovation costs for the private sector and will introduce constraints on policy to effectively compete in knowledge-based areas.

While there are many interesting debates that might be had about the directions the mega regionals are taking as regards market regulation, one thing seems reasonably clear: insofar as they are perfecting the policy framework that evolved in the supply side era, they are not working to cure the problems that have emerged under that framework. In quantitative terms, the permanent, but relatively small, income gains the mega regionals will generate, based on conventional computable general equilibrium (CGE) modelling, will not offset even one year's worth of the supply side era growth discount, let alone capture the growth premium that arguably should have been within reach.

Developing countries need to be aware of the weaknesses of the economic model that the mega regionals are promoting and also need strategies to attenuate the near-term negative impacts that the mega regionals will have on their economies while they sort out a better way forward. This note suggests seven damage control measures that they can take. The mega regionals are having discussions behind closed doors. The excluded can have discussions as well.

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Annex 1: Spillover Effects of the TPP on Excluded Parties, by Measure, and Possible Responses

Measure	**Description**	**Impact on Excluded Parties**	**Response**
Border Measures			
Elimination/reduction of tariffs	This entrenches the free trade model.	Significant trade diversion is to be expected in some sectors (e.g., in textiles and clothing) for non-members, including through preference erosion for developing countries	South-south preferential trade agreements
Lock-in of tariff cuts	No new duties and no provision for withdrawal with compensation – limits use of duties for new unbound areas.	Trade diversion by reducing uncertainty of market access within the mega regional zones	South-south preferential trade agreements
Waivers of duties	No new waivers conditional on investment performance requirements – limits use of waivers for foreign direct investment (FDI) attraction.	Excluded parties retain greater policy space	
Prohibition of export duties	Limits use of export tariffs to promote local processing (e.g., restricts future bans on export of logs to promote milling).	Excluded parties retain greater policy space	
Customs administration	Same direction as WTO Trade Facilitation Agreement (TFA) and promotes integrative trade.	Border cost reduction within mega regional zones diverts trade and value chain links	Investment to reduce border costs to competitive levels
Rules of origin	Measures compromise access to value chains for non-TPP parties.	Trade diversion for intermediate goods and services inputs	South-south preferential trade agreements

Technical Barriers to Trade (TBT)			
International standards	Language for adherence to international standards with likely specific reference to those recognized by the WTO TBT Committee	Access to mega regional markets restricted if excluded parties do not raise domestic standards	Investment and policy reforms required to upgrade standards to maintain competitive market access
Duplicative testing and certification	Best efforts to implement to harmonize standards	Potential positive spillover on excluded parties from reduced need for multiple certification to serve mega regional markets if standards are harmonized.	
Mutual recognition	Best efforts to implement	Potential negative spillover through erosion of competitiveness if cost reduction within mega regionals is through exclusive MRAs	
Participation in development of standards	Governments will be required to provide the opportunity to the private sector to participate in standards development.	Excluded parties' interests not taken into account in setting standards (e.g., threshold values)	Lobby for multilateralization of this commitment
Sanitary and Phytosanitary (SPS) Measures			
Standards	Normative language re: science – and risk-based assessments for SPS measures.	Potential positive spillover on excluded parties from reduced risk of market access due to procedural requirements in mega regional markets which are likely to be implemented on a multilateral basis. Science based standards can be used for protectionist as well as offensive objectives, ensuring access of advanced country products into developing country markets while blocking imports	
Confirmatory test	Permissive language for confirmatory test – likely following WTO TFA.	No additional constraint	
Customs SPS practices	Likely to follow WTO TFA.	No additional constraint	

Dispute Settlement	Rapid response mechanism to address perishables held up at the border. US is ambivalent about introducing dispute settlement on SPS issues (Fergusson et al. 2015).	No additional constraint	
Goods Market Access Measures (additional to tariffs and TBT/SPS)			
Agriculture - TRQs	Main impact will likely be on tariff rate quota (TRQ) administration.	Potential positive spillover on excluded parties from more transparent TRQ administration	
Agriculture – export competition & food security	Provisions related to agricultural export competition and food security are under discussion.	Potential positive spillover on excluded parties from greater disciplines on subsidized exports of mega regional parties	
Services Measures (General)			
Negative List	TPP market access likely on a negative list basis, which limits future policy room.	Excluded parties retain greater policy space, but will not have the benefit of additional market access available to members of TPP	
Market Access	Binding of present policy for market access.	Excluded parties retain greater policy space, but will not have the benefit of bound policy applied to their exports	
No local presence	Ability to supply services without establishing an office.	Erosion of competitiveness due to cost reduction within mega regionals	Improve domestic investment regimes in line with new norms
Most Favoured Nation (MFN) ratchet	National treatment and MFN "ratchet" may constrain new FTA offers.	Excluded parties retain greater policy space	
Other measures	General transparency measures and rules governing administrative practice.	Potential positive spillover on excluded parties from increased transparency	
Investment Measures (WTO does not have these disciplines in general)			
Pre- and post-establishment national treatment	Modern treatment covers: "The establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory" (KAFTA, 2014: 11.4).	Potential negative spillover through erosion of competitiveness through cost reduction within mega regionals	Improve domestic investment regimes in line with mega regional norms

MFN ratchet	MFN "ratchet" may constrain new FTA offers.	Potential positive spillover on excluded parties from increased transparency, but may be excluded from additional market access made available through this process to TPP members	
Minimum standard of treatment	Good regulatory practice.	Potential positive spillover on excluded parties from increased transparency, but may not be able to take for granted that treatment of their exports would be similar to that for TPP members	
Performance requirements	Prohibition of performance requirements covers technology transfer.	Excluded parties retain greater policy space; potential negative spillover through erosion of competitiveness as mega regionals improve as investment location	Improve domestic investment regimes in line with mega regional norms
Composition of senior management and boards	Limits nationality requirements.	Excluded parties retain greater policy space; potential negative spillover through erosion of competitiveness as mega regionals improve as investment location	Improve domestic investment regimes in line with mega regional norms
Investor-state dispute settlement (ISDS)	Extensive network of bilateral investment treaties (BITs) with ISDS and scope for multinational forum shopping mitigate marginal effect of mega regionals.	Excluded parties retain greater policy space; potential negative spillover through erosion of competitiveness as mega regionals improve as investment location	Improve domestic investment regimes in line with mega regional norms
Government Procurement Measures			
Expansion of WTO Government Procurement Agreement (GPA)	Revised WTO GPA represents a minimum target for the TPP. Only four TPP members are currently parties to the GPA (Canada, Japan, Singapore and the United States). In the shadow of the TPP negotiations, New Zealand joined the GPA.	Excluded parties retain greater policy space, but have lower market access to Government Procurement market.	
GPA+ measures	Procedural rules may constrain the role of government as "launch customer".	Excluded parties retain greater policy space	
E-commerce Measures			

General	No WTO e-commerce regime despite long-standing work program; rules being developed by WIPO, UNCITRAL, Hague Conference, ICANN, with input from OECD, G8, APEC, World Bank, EU leadership on cross-border issues – emerging architecture promoted in general by mega regionals.	Potential positive spillover on excluded parties from improved regimes for e-commerce within mega-regional markets; potential negative spillover through erosion of competitiveness as e-commerce firms within mega regional markets emerge as the biggest winners from pro-competitive effects	
Requirements relating to data transfer	Data storage location affects a variety of policies (privacy; ability to regulate in financial services; etc.) Restrictions on data transfer work as industrial policy to promote local digital economy development. TPP is likely to limit ability to restrict cross-border data transfer.	Excluded parties retain greater policy space, but may lose out on market access through transfer of data from their territory if conditions are not met.	
Intellectual Property (IP) Measures			
General enforcement of IP	Countries with weak basic IP benefit from stronger IP regime from enhanced innovation; countries with adequate basic IP experience negative side effects can impede technology-based re-innovation by SMEs: proliferation of low value patents; the "anti-commons" (thickets of patents around an invention); and the emergence of "patent assertion" entities	Excluded parties retain greater policy space; potential negative spillover through erosion of competitiveness as mega regionals improve as investment location; and limits on access to mega regional markets	Opportunities to capture activity in innovation that is not patent-centred beyond WTO TRIPS Agreement

Pharmaceutical patent package	Patent term extensions to compensate for patent approval periods; expanded scope of patentability (diagnostic, therapeutic, and surgical methods); lower thresholds (evergreening); limitations on patent revocation; linkage between patent status and regulatory approval of competing generics; extended test data exclusivity to delay entry of generics; requirement for national exhaustion of patent protection, which restricts scope for parallel importation; narrower scope for compulsory licensing; and limits on countries benefit from TRIPS public health measures.	Excluded parties retain greater policy space but with limits on access to mega regional markets	Opportunities ingenerics industry
Copyright extension	Additional costs imposed on derivative re-innovation with minimal incentive for additional creative work.	Excluded parties retain greater policy space but with limits on access to mega regional markets	Expanded opportunities to capture derivative innovation
Digital rights management	TRIPs-plus measures are not aligned with new innovation modes: incremental, "grain-sized" innovations, open-source/community-based.	Excluded parties retain greater policy space but with limits on access to mega regional markets	Expanded opportunities to capture derivative innovation
Competition Measures (WTO does not have these disciplines in general)			
General	WTO working program on competition abandoned; FTAs are developing practice, but mainly with soft law – i.e., non-binding measures that help establish norms which, in general, are good practice for domestic regulation.	Excluded parties retain greater policy space but with limits on access to mega regional markets	
Designated monopolies	Act solely in accordance with commercial considerations in non-public service mandates.	Excluded parties retain greater policy space but with limits on access to mega regional markets	
State-Owned Enterprises (SOEs) Measures			

General	Direction is clear: "competitive neutrality"; success in agreeing specific rules is unclear. Underlying principles emerging: ▪ OECD State-Owned Enterprise Guidelines (2005, 2014 review); ▪ IMF Santiago Principles for Sovereign Wealth Funds (2008); and ▪ World Bank Report on the Corporate Governance of State-Owned Enterprises (2014).	Excluded parties retain greater policy space but with limits on access to mega regional markets	
Regulatory Cooperation Measures			
	Highly controversial area, no working model, and leaked drafts were rudimentary and rough. As a first effort in this area, the TPP is unlikely to make significant headway beyond transparency measures scattered in other chapters and mechanisms for participation in standards setting.	Spillovers may be limited immediately but the constraints are likely to be dynamic. May be exclusionary or inclusive, depending on whether mega regionals result in harmonization or default to (exclusive) mutual recognition regimes.	
Labour and Environmental Measures			
	Standard texts require states to enforce own labour laws and promote adoption of ILO standards; similar provisions apply to environmental laws to restrict exploitation of low standards for international competitive advantage.	Excluded parties retain greater policy space but with limits on access to mega regional markets	
Currency Manipulation Measures			
	No working model; unlikely to be included.	No immediate constraint, but the TPP will serve as a training ground for possible approaches	