

STREAM READINGS

**TRADE POLICY:  
CONTEMPORARY  
ISSUES**



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## Trade Policy: Contemporary Issues

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### Description

The legal terrain for trade has undergone a series of reorientations over the last decades, from multilateral to bilateral, to regional – and now to a complex and variegated set of overlapping regimes. We will consider the political – and economic – stakes involved for nations with various perspectives and economic strategies as they engage the regime. Our aim is to help clarify the choices embedded in current regions and options for their productive contestation and change.

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## *Introduction*

This book aims to change the way you think about globalization. The central assertion is that revolutionary changes in communication technology fundamentally changed globalization around 1990. The logic of how the revolution in information and communication technology (ICT) transformed globalization and its impact on the world is simple, but understanding it requires some background. Let's start with some facts.

Globalization took a leap forward in the early 1800s, when steam power and global peace lowered the costs of moving goods. Globalization made a second leap in the late twentieth century when ICT radically lowered the cost of moving ideas. As Figure 1 shows, these two leaps—call them the Old and New Globalizations—had dramatically different effects on the world's economic geography.

From the early nineteenth century, falling trade costs fueled a cycle of trade, industrialization, and growth that produced one of history's most dramatic reversals of fortune. The ancient civilizations in Asia and the Middle East—which had dominated the world economy for four millennia—were displaced in less than two centuries by today's rich nations. This outcome, which historians call the “Great Divergence,” explains how so much economic, political, cultural, and military power came to be concentrated in the hands of so few.

From 1990, the trend flipped; a century's worth of rich nations' rise has been reversed in just two decades. Their share is now back to where it was in 1914. This trend, which might be called the “Great Convergence,” is surely the dominant economic fact of the last two or three decades. It is the origin of much of the anti-globalization sentiment in rich nations, and much of the new assertiveness of “emerging markets.”

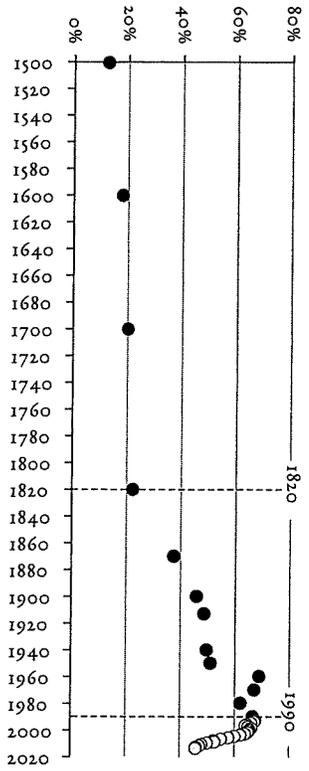


FIGURE 1: Globalization changed around 1990: the “shocking share shift” (G7 share of world income).

Modern globalization, which started around 1820, was associated with the rapid industrialization of today’s rich nations—represented in this chart by the Group of Seven nations, or G7 for short (United States, Germany, Japan, France, Britain, Canada, and Italy). This triggered a self-perpetuating spiral of industrial agglomeration, innovation, and growth that produced an epic shift in the world economy. From 1820 to about 1990, the G7’s share of global income soared from about a fifth to almost two-thirds.

The upward spiral was checked from the mid-1980s and reversed around 1990. For the last couple of decades, the G7 share has been tottering downward at a mighty pace. Today it is back to the level that it first attained at the very beginning of the nineteenth century.

This shocking share shift suggests that the nature of globalization changed radically around 1990.

DATA SOURCE: World Bank DataBank (GDP in U.S. dollars) and Maddison-project data pre-1960 (with author’s calculations), <http://www.ggd.net/maddison/maddison-project/home.htm>; the 2009 version is used since the 2013 version does not update world GDP (2009 version hereafter noted as Maddison database).

Accompanying Figure 1’s “shocking share shift” was a changeover in manufacturing. Today’s rich nations—which had seen their share of world manufacturing slip slowly since 1970—witnessed an accelerated decline from 1990 (Figure 2).

Curiously, the G7’s share loss showed up as share gains in very few nations. Only six developing nations (called the I6 in the chart, short for the Industrializing Six) saw their share of world manufacturing

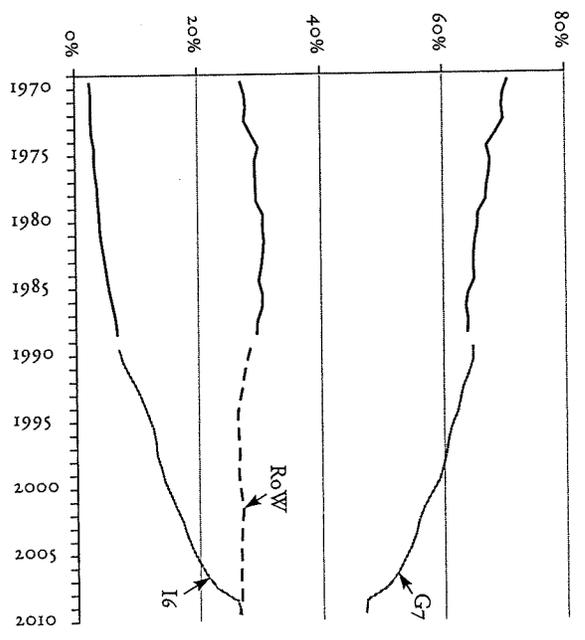


FIGURE 2: The decline in rich nations’ share of world manufacturing translated to gains by just six developing nations.

The shift in global manufacturing shares was almost as stark as the “shocking share shift” in Figure 1. From around 1990, the slide in the G7’s share accelerated and its share is now below 50 percent.

Just six developing nations—which I call the Industrializing Six, or I6 for short (China, Korea, India, Poland, Indonesia, and Thailand)—accounted for almost all of the G7’s decline. The manufacturing share of the rest of the world (ROW in the chart) was largely unaffected by these changes. Note that China is a real standout. Its share of world manufacturing (not shown separately) rose from about 3 percent to almost a fifth.

DATA SOURCE: UNSTAT.org

rise by more than three-tenths of one percentage point since 1990. The curiosity lies in the fact that the effect is so concentrated.

Why should the impact of globalization be so narrow geographically when cheap transportation and communication are so broadly available? Answering this question requires a broader view of globalization.

## A Broader View of Globalization

When transportation involved wind power by sea and animal power by land, few items could be profitably shipped over anything but the shortest distance. This fact made production a hostage of consumption since people were tied to the land. Production, in other words, was forcibly bundled with consumption.

Globalization can be thought of as a progressive reversal of this forcible bundling. But the bundling was not enforced by shipping costs alone. Three costs of distance mattered: the cost of moving goods, the cost of moving ideas, and the cost of moving people. It is useful to think of the three costs as forming three constraints that limit the separation of production and consumption.

One of this book's core assertions is that understanding the evolving nature of globalization requires a sharp distinction among these three "separation" costs. Since the early nineteenth century, the costs of moving goods, ideas, and people all fell, but not all at once. Shipping costs fell radically a century and a half before communication costs did. And face-to-face interactions remain very costly even today.

Thinking about why the sequence matters is facilitated by a new view of globalization—what I call the "three cascading constraints" perspective. The new view is best explained by tracing it onto the back of a quick gallop through history.

### *The Pre-Globalized World and Globalization's First Acceleration*

In the pre-globalization world, distance isolated people and production to such an extent that the world economy was little more than a patchwork of village-level economies. Things started to change when the cost of moving goods fell. Transport technologies improved in a process that fostered and was fostered by the Industrial Revolution.

With easier international shipping, more people bought faraway goods. Middle-income Britishers could, for example, afford to dine

on bread baked with U.S. wheat while sipping tea brewed from Chinese leaves and sweetened with Jamaican sugar—all set on a tablecloth made of Indian cotton. Oxford economist Kevin O'Rourke and Harvard economist Jeff Williamson date the start of this process to 1820. In my 2006 paper, "Globalization: The Great Unbundling(s)," I refer to this separation of production and consumption as globalization's first unbundling.

While shipping got cheaper, the costs of moving ideas and people fell much less. This unbalanced reduction of separation costs triggered a chain of causes and effects that eventually produced enormous income differences between today's developed nations (called the "North" for short) and today's developing nations (the "South"). First, markets expanded globally but industry clustered locally. As history would have it, industry clustered in the North. This Northern industrialization fostered Northern innovation, and since ideas were so costly to move, Northern innovations stayed in the North. The result was that modern, innovation-fueled growth took off sooner and faster in the North. In just a few decades, the resulting growth differences compounded into the colossal, North-South income asymmetries that define the planet's economic landscape even today. In short, the Great Divergence was produced by the combination of low trade costs and high communication costs.

### *Globalization's Second Acceleration (the Second Unbundling)*

Globalization accelerated again from around 1990, when the ICT revolution radically lowered the cost of moving ideas. This launched globalization's next phase—call it the "second unbundling" since it involves the international separation of factories. Specifically, radically better communications made it possible to coordinate complex activities at distance. Once this sort of offshoring was feasible, the North-South wage gap that had arisen during the first unbundling made it profitable.

The offshoring of production stages to low-wage nations changed globalization, but not just because it shifted jobs overseas. To ensure that the offshored stages meshed seamlessly with those left onshore, rich-nation firms sent their marketing, managerial, and technical know-how along with the production stages that had been moved offshore. As a consequence, the second unbundling—sometimes called the “global value chain revolution”—redrew the international boundaries of knowledge. The contours of industrial competitiveness are now increasingly defined by the outlines of international production networks rather than the boundaries of nations.

A sports analogy helps explain how this could so thoroughly transform globalization’s impact. Imagine two soccer clubs sitting down to discuss an exchange of players. If a trade actually occurs, both teams will gain. Each gets a player of a type they really needed in exchange for a type of player they needed less.

Now consider a very different type of exchange. Suppose on the weekends, the coach of the better team starts to train the worse team. The outcome of this will surely make the league more competitive overall and it will surely help the worse team. But it is not at all sure that the best team will win from this exchange—even though their coach will profit handsomely from being able to sell his know-how to two teams instead of one.

The parallels with globalization are plain. The Old Globalization can be thought of as swapping players. The New Globalization is more like the cross-team training with the offshoring firms playing the coach’s role.

Putting it differently, ICT-enabled offshoring created a new style of industrial competitiveness—one that combined G7 know-how with developing-nation labor. Because this high-tech, low-wage combination turned out to be a world beater, the easier movement of ideas sparked massive North-to-South flows of know-how. It is exactly these new knowledge flows that make the New Globalization so different from the Old Globalization.

### *Curiously Concentrated Effects and the Commodity Super-Cycle*

Importantly, G7 firms own this know-how, so the new North-to-South knowledge movements should not be thought of as some enormous “Kumbaya moment.” Rich nations are not sending their know-how to poor nations in a burst of caring and sharing. G7 firms work hard to ensure that their offshored knowledge stays within the confines of their production networks. According to the three-cascading-constraints view, this is why the manufacturing miracle happened in so few developing nations. To use the sports analogy, the New Globalization only boosted the manufacturing fortunes of the “teams” that the G7 coach decided to “train.” But why was the training so curiously concentrated?

The answer, in my view, turns on the cost of moving people, not goods or ideas. Airplane fares have fallen, but the time-cost of travel has continued to rise with the salaries of managers and technicians. Since it is still expensive to move people—and international production networks still need people to move among facilities—offshoring firms tend to cluster production in a few locations. Again to economize on the cost of moving people, these locations tend to be near the G7 industrial powerhouses, especially Germany, Japan, and the United States. India is an exception, but mostly because India has engaged in international production networks primarily via the types of services for which frequent face-to-face interaction is less of an issue.

While the second unbundling’s impact on industrialization was hyper-concentrated, the Great Convergence was a much broader phenomenon due to knock-on effects. About half of all humans live in the developing nations that are rapidly industrializing, so their rapid income growth created a booming demand for raw materials. Booming demand, in turn, created the “commodity super-cycle,” which subsequently sparked growth takeoffs in many commodity-exporting nations that were untouched by the emergence of global value chains.

## Globalization's Next Big Thing: Globalization's Third Unbundling

The three-cascading-constraints narrative—which is summarized graphically in Figure 3—plainly admits the possibility of a third unbundling, if face-to-face costs plunge in the way coordination costs

FIGURE 3: Summary of the “three cascading constraints” view of globalization.

When horse carts and sailing ships were high-tech, goods, ideas, and people mostly stayed put. For the vast majority of humanity, economic life was organized at the village-level (top panel).

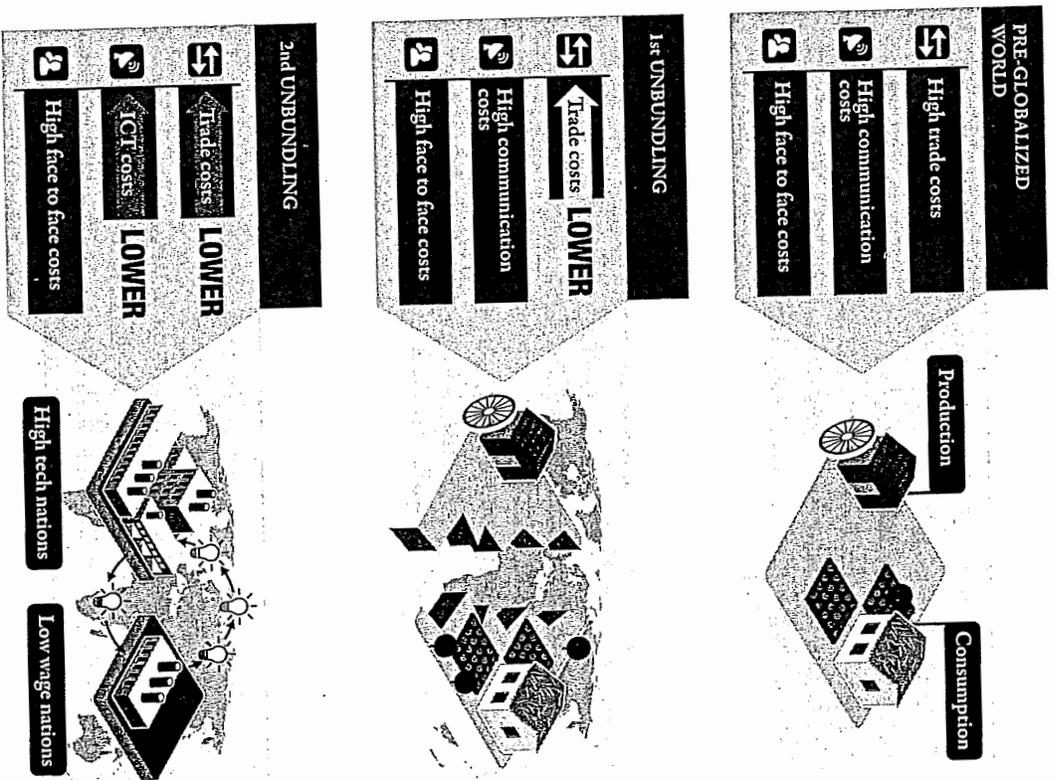
Steamships and railroads radically lowered the cost of long-distance trade, allowing production and consumption to separate in what could be called globalization's first unbundling (middle panel). But relaxing the shipping constraint did not make the world flat since the communication and face-to-face constraints were still in evidence. Indeed, even as production moved away from consumption, manufacturing gathered into factories and industrial districts—not to economize on trade costs, but rather to save on communication and face-to-face costs.

This microclustering spurred innovation in industrializing nations, and the innovations stayed local due to the high cost of moving ideas. The result was that know-how-per-worker rose much faster in the North than it did in the South. Ultimately, this is what created the great North-South income divide known as the Great Divergence.

Globalization's second unbundling (bottom panel) became economical when revolutionary advances in information and communication technology made it possible to organize complex production processes even when they were separated internationally. When this technical possibility became a reality, low wages in developing nations enticed G7 firms to offshore some labor-intensive stages of production. Since the production stages that were offshored still had to fit flawlessly with those left onshore, the offshoring firms sent their know-how along with the jobs. In this way, the flows of knowledge that used to happen only inside G7 factories became a key player in globalization (light bulbs in bottom panel).

These new information flows allowed a handful of developing nations to industrialize at a dizzying pace—resulting in a massive shift of industry from the North to the South. This Southern industrialization—together with the commodity super-cycle it launched—propelled emerging market income growth rates to unprecedented levels. The result was the “shocking share shift” shown in Figure 1.

In a nutshell, this is how the ICT revolution transformed globalization and its impact on the world economy: up to 1990, globalization was mostly about goods crossing borders; now it is also about know-how crossing borders.



have since the 1990s. Two technological developments might provoke such a plunge. Really good substitutes for people crossing borders to share “brain services” is the first. Such technologies, known as “telepresence,” are not science fiction. They exist today but they are expensive. The second would be the development of really good substitutes for people traveling to provide manual services. This is called “teleroobotics” and it involves people in one place operating robots that perform tasks in another place. Teleroobotics exists, but it is still expensive and the robots are not very flexible.

Taken together, these developments may dramatically change the nature of globalization in coming decades. Both allow workers from one nation to perform service tasks inside another nation without actually being there. Such “virtual immigration,” or international telecommuting, would radically expand the range of jobs that are directly subject to international competition. Many mental and professional tasks in rich nations could be performed (remotely) by workers and professionals sitting in poor nations. It would also allow rich-nation professionals to apply their talents on a much wider basis. For example, Japanese engineers could repair Japanese-made capital equipment in South Africa by controlling sophisticated robots from Tokyo. Some people would win from this new competition / opportunity; others would have to find something else to do.

Thus globalization’s third unbundling is likely to involve workers in one nation providing services in another nation—including services that today require physical presence. Or to use the unbundling theme, globalization’s third unbundling is likely to allow labor services to be physically unbundled from laborers.

What Is New about the New Globalization?

The changed nature of globalization also means that nations are affected in many new ways. Six of them stand out.

*The New Globalization affects national economies with a finer degree of resolution.*

Twentieth-century globalization produced greater national specialization at the level of sectors. Lower trade costs thus tended to help or hurt whole sectors of the economy and the people working in them. Twenty-first century globalization, by contrast, is not just happening at the sector level; it is also happening at the level of production stages and occupations. As a result, globalization’s impact is more unpredictable.

Under the Old Globalization, nations could identify their “sunrise” and “sunset” sectors. No longer. Now we have sunrise and sunset stages and occupations in almost all sectors. As it turns out, one cannot accurately predict which stages and jobs will be affected next in a world where the contours of industrial competitiveness are defined by offshoring firms.

The New Globalization’s impact is also more individual in the sense that the winners and losers are no longer mostly grouped by sectors and skill groups. Globalization’s impact can vary across workers who possess the same skill sets and work in the same sectors. “Kaleidoscopic globalization” is how Columbia University economist Jagdish Bhagwati describes it. No matter what job you have and no matter what sector you work in, you cannot really be sure that your job won’t be the next to suffer or benefit from globalization.

The finer degree of resolution also has important policy implications. Many nations have policies aimed at helping declining sectors and disfavored skill groups, but globalization’s finer resolution means that such policies are insufficiently nuanced to distinguish among today’s winners and losers.

*The New Globalization’s impact is more sudden and more uncontrollable.*

The passage of time on the Old Globalization “clock” was marked in years, since that is how long it took for tariff cuts and transportation improvements to take effect. The New Globalization, by contrast,

is more sudden due to the fact that it is driven by the doubling of transmission, storage, and computing capacity every year or two. As we have seen repeatedly in the last couple of decades, exponential ICT improvements can turn implausible things into commonplace things in a matter of months.

The technical nature of ICT also means that national governments have less control over the New Globalization. The laws of physics make it easier to control the flow of goods than it is to control the flow of ideas. And politics reinforces the physics. The ideas are, after all, flowing out of G7 nations whose voters have embraced openness. Staunching the massive “knowledge arbitrage” that is now driving globalization would be next to impossible.

*The New Globalization denationalized comparative advantage.*

G7 firms are leveraging their firm-specific know-how by combining it with labor in low-wage nations. With firms mixing and matching different nations’ sources of competitiveness, nations are no longer the only natural unit of analysis. Increasingly, the boundaries of competitiveness are controlled by firms who run international production networks.

To put it differently, the first unbundling was all about allowing nations to better exploit their comparative advantages. The second unbundling is much more about allowing firms to boost their competitiveness by recombining national sources of comparative advantage.

*The New Globalization partly ruptured the compact between G7 workers and G7 firms.*

When technology was national, international wage gaps adjusted to international technology differences. For example, German wages rose when German technology advanced. The second unbundling partly disables this wage-technology equilibration process. The New Globalization means that German workers are no longer the only beneficiaries of German technological advances. German firms can

now exploit improved German technology by combining it with, say, Polish labor. Similar things could be said about firms and workers in all the G7 nations.

*The New Globalization changed the role of distance.*

Standard thinking characterizes globalization as being mostly about goods crossing borders. Doubling the distance between markets is thus naturally thought to roughly double the trade costs. Applying this logic today is a miscalculation of twenty-first-century globalization for a very simple reason.

Cartographical distances affect the cost of moving goods, ideas, and people in very different ways. With the Internet, the cost of moving ideas is almost zero and varies little with distance. For people, however, there is a big difference between destinations that can be reached with a day trip and those further out.

This may help explain why so few developing nations have been able to industrialize rapidly, despite having adopted all the right pro-business policies. To put it bluntly, they may simply be too far from Detroit, Stuttgart, and Nagoya compared to other developing nations.

*The New Globalization should change how governments think about their policies.*

Vast swaths of economic policy are based on the notion that competitiveness is a national feature. In rich nations, policies ranging from education and training (preparing workers for the jobs of tomorrow) to research and development tax breaks (developing the products and processes of the future) are aimed at bolstering national sources of competitiveness. In developing nations, policies ranging from tariff levels (protecting domestic production) to development strategies (moving up the value chain) are founded on the idea that the sources of national competitiveness are national.

All these policy presumptions need to be rethought in the light of the New Globalization. For example, denationalized competitive

advantage changed the options facing developing nations. Instead of building the whole supply chain domestically to become competitive internationally (the nineteenth- and twentieth-century way), developing nations now join international production arrangements to become competitive and then industrialize by getting more good jobs inside international value chains.

The flip side of this transfigured the competitiveness options facing rich nations. Globally competitive firms knit together national competitive advantages to make things in the most cost-effective locations. Firms and nations that eschew this new school of mix-and-match competitive advantage struggle to compete with those that have embraced it.

In short, the changed nature of globalization killed old-style development policies just as it killed naively nationalistic industrial policies in developed nations.

### Roadmap for the Reader

The rest of this book is presented in five parts. The first takes a short look at the long history of globalization using the concept of bundling and unbundling as the organizing principle. This history is covered in Chapters 1 through 3.

Part II, Extending the Globalization Narrative, comprises two chapters. Chapter 4 presents the three-cascading-constraints view in greater detail. Chapter 5 expands on what is really new about the New Globalization.

Part III, Understanding Globalization's Changes, has two chapters. Chapter 6 lays out the boot-camp economics of globalization, and Chapter 7 then uses this information to make sense of why globalization's impact changed so radically between the first and second unbundling.

Part IV turns to the implications of the New Globalization for policymaking. Specifically, Chapter 8 looks at what the changes

mean for G7 globalization policies and Chapter 9 does the same for developing nations.

Part V, entitled Looking Ahead, does exactly that by presenting a small number of conjectures about what the future holds for globalization and vice versa.

## The Battle to Define Asia's Intellectual Property Law: From TPP to RCEP

Anupam Chander\* and Madhavi Sunder\*\*

### Introduction

Two competing mega-trade agreements seek to write the rules for intellectual property for half of the world. One agreement anchored till recently by the world's largest economy, the United States, offers intellectual property rules that are generally stricter than those in the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property ("TRIPS"). With the exit of the United States from this negotiation, this Trans-Pacific Partnership would encompass eleven nations—Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. A second agreement, the Regional Comprehensive Economic Partnership ("RCEP"), anchored by the world's second largest economy, China, is the focus of a struggle between those who seek stronger intellectual property rights and those who seek to carve out greater limitations and exceptions to intellectual property.<sup>1</sup> Initially conceived by the Association of Southeast Asian Nations (ASEAN), which consists in Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam, RCEP includes the six states with which ASEAN has existing free trade agreements, namely, Australia, China, India, Japan, South Korea and New Zealand.<sup>2</sup> Yet to be finalized, this agreement seeks to write the intellectual property rules that would govern the lives of nearly half of the world's population and a third

of the world's gross domestic product.<sup>3</sup> Both treaties hope to ultimately attract many other countries, especially in Asia. The proponents of the TPP hope that it will lead to broader adoption in Asia and Latin America.<sup>4</sup> The proponents of the RCEP too hope that it will serve as a stepping stone towards an even broader Free Trade Area of the Asia Pacific. Before the exit of the United States from the TPP, the contest between the two mega-regional agreements has often been characterized as a struggle to bring the bulk of Asia into the American or the Chinese sphere of influence, as other states would vie for membership on terms that had already been decided by the original parties. But there is another crucial struggle that is almost entirely overlooked: a battle to define the intellectual property law for Asia in the twenty-first century.

Figure 1. Map of TPP and RCEP countries



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\*\* Senior Associate Dean and Daniel J. Dykstra Professor of Law, UC Davis; Harvard College; AB, J.D., Stanford Law School. We are grateful to Marisela Bernal, Wade Green and Anujun Jeeraparaksh for excellent research assistance. This article benefited from presentations to the UC Davis law faculty, and at a UC Irvine Law Review conference and the European Policy for Intellectual Property annual conference, where we received many helpful comments from experts including Irene Calboli, William Fisher III, Peter Lee, Haochen Sun, and Peter Yu. The views represented herein, as well as any errors, are the authors' alone.

<sup>1</sup> Seven states are members of both the TPP and RCEP groupings—Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam. The RCEP would create history's largest free trade zone, larger even than Genghis Khan's. See JACK WEATHERHORN, GENGHIS KHAN AND THE MAKING OF THE MODERN WORLD xix (2014) (creating Khan with creating "history's largest free-trade zone").

<sup>2</sup> For a history of RCEP negotiations, see Peter K. Yu, The RCEP and Intellectual Property Norm-setting in the Asia-Pacific (July 16, 2016), in Intellectual Property Rights and Mega-Regional Trade Agreements (2017).

Indeed, while the TPP has drawn the bulk of attention in the United States, it is the negotiations *within* RCEP that might ultimately have the greatest impact. This is because of two reasons. First, unlike the TPP, RCEP includes both China and India—the world's most populous countries—and will define intellectual property rights for half the world's population. Despite Asia's recent astonishing

<sup>3</sup> Jamie Love, 2015 Oct 16 version: RCEP draft text for investment chapter, "Collectively, these sixteen countries have a population of 3,488,410,867 in 2014, which was 48 percent of the world population of 7,260,710,677, according to the World Bank." <http://keoinc.org/node/2474>.

<sup>4</sup> "To that end, it contains clear rules and procedures for expanding participation to other countries that are able to fully implement and enforce the full range of TPP obligations. It also creates useful precedents for both broader Asia-Pacific economic integration and new initiatives that could revitalize plurilateral and multilateral trade talks in the WTO." <https://ustr.gov/sites/default/files/Advisory-Committee-Trade-Policy-and-Negotiations.pdf>. The TPP's proponents hope to ultimately include other countries in Latin America as well: "It will encourage the further evolution of free markets in Latin America through the inclusion of Chile and Peru and possibly others going forward." *Id.* at 6.

economic advances, the region still holds a startlingly enormous number of the world's poor, sick, and uneducated.<sup>5</sup> Intellectual property protections can indeed help spur medical advances and authorship, but they can also put medicines and textbooks out of the reach of billions of people. Second, India's intellectual property law and its ability to export medicines to other nations literally affect life and death across the world. South Africa's Health Minister Aaron Motsoaledi has called India the "pharmacy to the developing world."<sup>6</sup> India's role as the provider of affordable life-saving medicines for the developing world stands at risk, and depends on the results of this obscure and secret negotiation.

A leaked version of the RCEP intellectual property chapter, then, deserves careful study. The draft includes text that seems to be agreed on by all parties, as well as proposals, oppositions, and counterproposals with respect to language that is yet being negotiated. The leaked text tells us which countries are proposing or rejecting any particular controversial language, and thus gives us a unique glimpse into the process of international law-making. Of course, leaked texts are not necessarily accurate, but, lacking any alternative, we will proceed as though they are, with the caveat that they have not been officially acknowledged as accurate.

Not only is a study of the RCEP intellectual property chapter revealing because of its real-world consequences for access to medicines and access to knowledge, the study of the text also sheds light on fundamental theoretical inquiries about international law-making. What will a largely South-South intellectual property agreement look like? Do the local advanced nations—here Japan and South Korea—simply substitute for the Western metropole in a North-South agreement? Does an Asian trade agreement anchored by China and India reflect so-called "Asian Values" in any way?

Most strikingly, we conclude that the intellectual property chapter of the Asian-Pacific agreement would, if certain proposals are adopted, largely work to the benefit of United States and European enterprises. While the ratification of TRIPS by the developing world can be understood as simply concessions to gain better access to Western markets for developing country products, that rationale is absent here. Despite having been negotiated in the Asia-Pacific, RCEP may turn out to be largely a copy-and-paste job based on Western agreements.

We proceed below as follows. Part I offers the core of our argument—that proposed intellectual property provisions in RCEP are a threat to health and education worldwide by establishing TRIPS-plus obligations throughout the Asia-Pacific. Part II offers the most surprising insight in the paper—that these TRIPS-plus obligations negotiated among the largest Asian countries will principally benefit U.S. and European multinationals. Part III then evaluates aspects of the

treaty-making process, specifically, the claim that governments are rational national interest maximizers and that trade negotiations should remain secret. A short conclusion suggests that the RCEP intellectual property chapter should either be withdrawn or rewritten.

## I. Threats to Health and Education

While there have been international intellectual property treaties stretching back into the nineteenth century, it was only with the advent of the WTO in 1995 that international intellectual property law gained both widespread acceptance and enforceable rules. Indeed, the United States only came to implement the Berne Convention for the Protection of Literary and Artistic Works in 1989 during the WTO negotiations, more than a century after its initial adoption in 1886.<sup>7</sup> Peter Yu has described the TRIPS agreement as an "international enclosure movement ... requiring nations to adopt one-size-fits-all legal standards that ignore their local needs, national interests, technological capabilities, and public health conditions."<sup>8</sup>

Whatever its constraints and demerits from the perspective of developing countries, however, TRIPS does allow important flexibilities for policy choices on intellectual property within nations. Experts advise developing countries to exercise fully the flexibilities within TRIPS.<sup>9</sup> Over the intervening years since 1995, however, developed states have sought to close some of those loopholes through what have become known as "TRIPS-plus" provisions in bilateral and regional free trade agreements.<sup>10</sup> The United Nations Secretary-General's High-Level Panel on Access

<sup>5</sup> See infra notes 1–3, and accompanying text.

<sup>6</sup> Vidya Krishnan & Mandakim Cahor, *Why South Africa's health minister is so worried about India using its big pharma*, Scroll.in, Aug 10, 2015, <https://scroll.in/article/745344/why-south-africas-health-minister-is-so-worried-about-india-caving-in-to-big-pharma>.

<sup>7</sup> UN Treaties database.

<sup>8</sup> Peter K. Yu, *The International Enclosure Movement*, 82 *Ind. L.J.* 827, 828 (2007); see also Molly Land, *Rebalancing Trade*, 33 *Mich. J. Int'l L.* 433, 435–36 (2012).

<sup>9</sup> Commission on Intellectual Property Rights, *Integrating Intellectual Property Rights and Development Policy* (2012) ("TRIPS allows considerable flexibility in how countries may design their patent systems. Since most developing countries do not have a significant research capability, they have little to gain by providing extensive patent protection as a means of encouraging research, but they stand to lose as a result of the impact of patents on prices. Therefore, developing countries should aim for strict standards of patentability to avoid granting patents that may have limited value in relation to their health objectives. For instance, most developing countries should exclude diagnostic, therapeutic and surgical methods from patentability, including new uses of known products, as permitted under TRIPS. Developing countries should also make provisions in their law that will facilitate the entry of generic competitors as soon as the patent has expired on a particular drug."

<sup>10</sup> Cynthia M. Ho, *An Overview of TRIPS-Plus Standards in CYNTHIA M. HO, ACCESS TO MEDICINE IN THE GLOBAL ECONOMY: INTERNATIONAL AGREEMENTS ON PATENTS AND RELATED RIGHTS* (2011).

to Medicines has advised that TRIPS-plus agreements “may impede access to health technologies.”<sup>11</sup>

This is a charge leveled, for example, against the TPP, with its US-led effort to impose stricter intellectual property rules on countries like Vietnam. The TPP, for example, “obligates Vietnam to recognize IP rights for biologics,”<sup>12</sup> and increases copyright term lengths from 50 years after the death of the author or performer to 70 years after the death of the author or performer.

The RCEP, however, has been negotiated entirely within Asia-Pacific nations, outside the pressures brought to bear by the United States. But even within the Asia-Pacific region, there are countries that see a future in receiving royalties for intellectual property. Within the sixteen RCEP nations, Japan and South Korea are long-standing significant international intellectual property powers, with China emerging as a new international intellectual property power, and India occupying a middle role as an exporter of Bollywood movies. Both India and China are among what Peter Yu calls the “Middle Intellectual Property Powers”—which include Brazil, Russia, South Africa, and Thailand.<sup>13</sup>

Even these middle-income powers must be cautious in embracing ever stronger intellectual property rights. India is a major importer of patented inventions, Hollywood movies, and foreign English-language books, and its generics industry depends, as we shall see, on standards of patentability and an ability to export. Despite the immense strides in reducing poverty that they have made over the last few decades, many RCEP countries still face widespread and dire poverty. Figure 1 below sets out poverty statistics for the RCEP member states. The RCEP states hold more than 400 million people who earn less than \$1.90 a day, and more than a billion people who earn less than \$3.10 a day.

<sup>11</sup> [http://www.austlii.edu.au/other/aufrs/au/other/dfat/special/specialreport/specialreport4/](http://www.austlii.edu.au/au/other/aufrs/au/other/dfat/special/specialreport/specialreport4/). The Special Rapporteur on the right of health also called on countries to avoid TRIPS-plus commitments in their laws and treaties. *Annual Report, Report of the Special Rapporteur on the right of everyone to the enjoyment of the highest attainable standard of physical and mental health*, 31 March 2009, UN Doc. A/HRC/11/12.

<sup>12</sup> Peter K. Yu, *The Middle Intellectual Property Powers*, in LAW AND DEVELOPMENT OF MIDDLE-INCOME COUNTRIES, 84, 89–91 (Randall Perrenboom & Tom Ginsburg eds., 2014).

*Figure 2: Extremely Poor Persons in RCEP Region<sup>14</sup>*

Country	Total Population	Number at \$1.90/day	Number at \$3.30/day
Cambodia	14,832,255	300,000	3,200,000
China	1,350,695,000	87,300,000	257,300,000
India	1,247,446,011	268,000,000	731,900,000
Indonesia	248,037,853	29,200,000	103,400,000
Laos	6,473,050	1,100,000	3,000,000
Philippines	96,017,322	12,600,000	36,100,000
Thailand	67,164,130	0	800,000
Vietnam	88,809,200	2,900,000	12,300,000
TOTAL	3,298,786,504	401,400,000	1,148,000,000

While the sixteen RCEP negotiating parties are not themselves classified as Least Developed Countries by the United Nations, the Asia-Pacific region is home to more than a dozen such countries: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People’s Democratic Republic, Myanmar, Nepal, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu, and Yemen. If RCEP is expanded to encompass these countries, it will effectively write the intellectual property law of some of the very poorest countries in the world.

Health costs, of course, are not the concern of the poorest alone. Many countries in the region have increasing obligations to care for aging populations. Aging populations mean increased demand for health technologies. Even though South Korea and Japan are major intellectual property powers, they have two of the world’s most rapidly aging societies, and thus stand to become significant importers of medicines and other intellectual property. As Figure 4 shows, more than a quarter of Japan’s population is already aged 65 or older, far higher than the fifteen and thirteen percent share of the United States’ and South Korean populations, respectively.<sup>15</sup> In Japan, “[D]eaths have outpaced births for several

<sup>14</sup> 2012 statistics, except for India, which is for 2011; all figures are adjusted for Purchasing Power Parity. — World Bank statistics. No figures provided for Brunei, Japan, Myanmar, New Zealand, Singapore, or South Korea. For Thailand, the number of persons at \$1.90/day is given as zero because of rounding.

<sup>15</sup> WORLD BANK, *World Development Indicators Database* (July 30, 2017), <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on>.

years.<sup>316</sup> By 2050, Japan expects fully 39% of its citizens to be aged 65 or older by 2050.<sup>17</sup>

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In short, Asia faces three critical, interrelated crises impacted by the contours of intellectual property rights: dire poverty, widespread morbidity and an aging population, and the need to improve the educational attainment of its population. We turn now to analyzing the RCEP provisions impacting these crises.

#### A. Access to Medicines

The RCEP has the potential to severely restrict access to essential medicines for the world's poor. According to the latest leaked draft, proposals in RCEP<sup>18</sup> would (1) extend patent terms to compensate for delays<sup>19</sup> in granting patents or in obtaining marketing approval;<sup>20</sup> (2) adopt new exclusive rights in clinical-trial data;<sup>21</sup> (3) potentially reject flexibilities, provisions for compulsory licenses and extensions for deadlines to reform pharmaceutical patent laws in Least Developed Countries (LDCs); (4) adopt TRIPS-plus border measures; and (5) adopt investor-state dispute resolution process that would create state liability for regulating IP to promote public health. These provisions in RCEP are particularly risky because they would negatively affect India, the largest global supplier of generic medicines, thereby significantly affecting access to essential medicines in Africa, Latin America and other parts of the developing world.

<sup>16</sup> Jonathan Soble, *Japan: Short on Rabbits, Ready for Wolfpacks: Militation*, N.Y. Times, June 2, 2017.

<sup>17</sup> Jack Dallen, *The Issue of Japan's Aging Population*, Law School International Immigration Program Papers, No. 8 (2016) (citing Statistics Bureau, Statistical Handbook of Japan 2013, Chapter 2—Population” (2016) available at <http://www.stat.go.jp/english/data/nenshu/pdf/yhyou2.pdf>).

<sup>18</sup> The TPP would go further yet by requiring a low standard of patentability that would allow patents for mere modifications and tweaks. Nana Singh et al., Influence of Patent Law on Price of Medicines: A Comparative Analysis of Various Countries, in Patent Law and Intellectual Property in the Medical Field 20, 31 (Rashmi Agarwal & Kandeer Kaur, eds. 2017) (TPP requires patents for “[p]ew uses of a known product; [p]ew methods of using a known product; [p]ew processes of using a known product.”); Lower patentability standards allow for more patents and longer patents—hence the name “evergreen” patent. Innovators can go for low hanging fruit—extensions on existing patents—rather than focus on breakthrough inventions with proven therapeutic benefit. See Brook Baker, *Trans-Pacific Partnership Provisions in Intellectual Property, Transparency, and Investment Chapter: Threats to Medicines in the US and Elsewhere*, PIAS Med 13(3), page 3 (2016).

<sup>19</sup> RCEP Art. 5.13.3 (“Each Party, at the request of the patent owner, shall adjust the term of a patent to compensate for unreasonable delays that occur in granting the patent.”)

<sup>20</sup> RCEP Art. 5.13.1 (“With respect to the patent which is granted for an invention related to pharmaceutical products, each Party shall, subject to the terms and conditions of its applicable laws and regulations, provide for a compensatory term of protection for any period during which the patented invention cannot be worked due to marketing approval process.”)

<sup>21</sup> RCEP Art. 5.16.

There are a number of provisions that may undermine public health in the RCEP. First, Japan and South Korea seek an extension of a patent term for pharmaceuticals to compensate for the time needed to obtain marketing approvals.<sup>22</sup> This language is stronger than the TPP, which limits such extensions to cases of “unreasonable curtailment” of the effective patent term.<sup>23</sup> Additionally, South Korea proposes to extend the patent terms in the case of “unreasonable delays” in the granting of the patent itself, though India, China, ASEAN oppose this, joined in this case by Japan.<sup>24</sup>

Second, the leaked draft proposes data exclusivity for drug companies, protecting clinical trial data needed for regulatory approval in addition to the patented drugs themselves, thereby making generic drug production much more onerous. Japan and South Korea seek to slow competition from generics by preventing the use for five years (counting from the date of approval) of data provided by the first applicant for marketing approval—the precise term of data exclusivity agreed to in the TPP.<sup>25</sup> Unlike the TPP, RCEP does not include *de jure* protections for the new class of medicines known as biologics, but the other protections available for medicines would likely apply to this class of drugs.<sup>26</sup> Thus, if they wish to enter the market for a particular drug in a timely fashion, generic drug makers would have to invest in their own expensive and time-consuming drug trials before production—wastefully repeating the work already performed. Both patent term extensions and data exclusivity ultimately have effect of delaying the market entry of generic medicines and increasing public health costs for governments.

Third, Japan and South Korea oppose Article 5.7 of the RCEP, proposed by ASEAN, India, New Zealand and China, which recognizes “TRIPS flexibilities for Compulsory Licenses and LDC Extensions.” Currently, the WTO has pushed back the date for Least Developed Countries’ compliance with TRIPS provisions regarding pharmaceuticals to 2033. Japan and South Korea appear ready to reject widely accepted TRIPS flexibilities, even those that would only target the very poorest countries in the world.

<sup>22</sup> RCEP, Art. 5.13.1.

<sup>23</sup> TPP, IP Chapter, Art. 18.48.

<sup>24</sup> RCEP Art. 5.13.3 (defining unreasonable delay as “a delay in the issuance of the patent of more than four years from the date of filing of the application in the territory of the Party, or three years after a request for examination of the application, whichever is later. Periods attributable to actions of the patent applicant need not be included in the determination of such delays.”)

<sup>25</sup> RCEP Art. 5.16; TPP, art. 18.50.

<sup>26</sup> Carlos Christopher Smith Diaz, *Diving into the Fog of Ambiguity: An Analysis of the Trans-Pacific Partnership’s Data Exclusivity Provisions and Their Implications for Access to Medicines in New Zealand*, 48 Vict. U. Wellington L. Rev. 1 (2017).

Fourth, while TRIPS explicitly excludes the requirement to police goods in transit,<sup>27</sup> RCEP reintroduces this issue, though in a moderate form. The text reads: “The Parties shall cooperate on border measures [IP propose; ASN/JN oppose: such as exchanging information which is conducive to identification of suspects in importation, exportation or transit] with a view to eliminating trade which infringes intellectual property rights.”<sup>28</sup> Even though India opposes the references to “transit” favored by Japan, it has not registered opposition to the more general requirement to cooperate on eliminating trade infringing on intellectual property rights. This potentially jeopardizes the transfer of medicines from one developing country (where they are legal to manufacture) to another developing country (where they are legal to sell) if they pass through a country that declares those medicines infringing.

Finally, the RCEP includes an investor-state dispute resolution provision that would allow ordinary regulatory actions of states to protect public health to be challenged for violating a foreign investor’s intellectual property rights. The traditional remedy for a country’s failure to enact and enforce intellectual property provisions in a trade agreement is to require that country to bring its regulations into compliance after a dispute resolution proceeding conducted between states.<sup>29</sup> An alternative, and potentially far more expansive and expensive, remedy emerges through the investment chapters in free trade agreements or bilateral investment treaties. Such chapters can permit a foreign company to bring an arbitration claim against a country for compromising the value of its intellectual property in the country. The RCEP draft appears poised to bring intellectual property claims before the purview of the investor-state dispute resolution system, thereby permitting foreign intellectual property holders to claim that a national or local government had improperly expropriated their investment. The draft text includes both “direct or indirect” expropriation, permitting a claim when a “government action interferes with distinct, reasonable investment-backed expectations.” “[Q]uoted investments” subject to the investment chapter specifically include

<sup>27</sup> TRIPS, footnote 13: “It is understood that there shall be no obligation to apply such procedures to imports of goods put on the market in another country by or with the consent of the right holder, or to goods in transit.”

<sup>28</sup> RCEP Art. 10.2.3.

<sup>29</sup> This is the standard remedy for TRIPS violations, for example. If a country fails to comply with an adverse ruling, the dispute settlement body can authorize retaliatory removals of trade concessions or, far more rarely, the nations can settle the matter through the negotiation. See KEITH EUGENE MASKIN, PRIVATE RIGHTS AND PUBLIC PROBLEMS: THE GLOBAL ECONOMICS OF INTELLECTUAL PROPERTY IN THE 21ST CENTURY 109 (2012) (describing U.S.-European Union settlement following U.S. failure to comply with adverse TRIPS ruling in case involving public performance in business venues).

intellectual property. India has no objection to including intellectual property within the ambit of investor-state dispute resolution,<sup>30</sup> nor for that matter does China.<sup>31</sup>

Seen from one perspective, there is nothing remarkable about recognizing intellectual property as a valuable investment in a country, which can accordingly be expropriated. But by moving intellectual property violations of a trade agreement into investor-state dispute resolution, intellectual property receives far stronger protection than the goods and services rules that are the core of trade agreements. Violations of liberalization commitments for goods or services only carry the possibility of retaliatory restatement of trade barriers, not extensive damages paid from the national coffers. Furthermore, goods and services violation claims can only be brought by states, not by the adversely-affected enterprises themselves. RCEP will thus result in more, and larger, intellectual property claims.

Recent investor-state dispute resolution cases demonstrate the types of intellectual property claims that might be brought, and even show the risks they present for health. Phillip Morris brought claims against Uruguay and Australia for public health-related cigarette packaging requirements that interfered with its use of its trademarks, seeking some \$22 million plus compound interest from Uruguay. Eli Lilly brought an arbitral claim against Canada after a Canadian court invalidated its patent on the drug Strattera. Eli Lilly sought damages of \$500 million from Canada for denying patent rights to this drug and another drug, Zyprexa.<sup>32</sup> Defending such a claim can be quite expensive. When a tribunal at the International Center for Settlement of Investment Disputes (ICSID) dismissed all claims brought by Phillip Morris against Uruguay, the tribunal ordered the company “to pay Uruguay US\$7 million as partial reimbursement of the country’s legal expenses.”<sup>33</sup> Had Uruguay lost, it might have had to pay Phillip Morris’s legal fees, as requested by Phillip Morris.<sup>34</sup> While these cases have not yet proven successful, similar cases may yet prove successful in the future—and they also send a “regulatory chill . . . on efforts by states to regulate IP industries,” as James Guthrie and Cynthia Ho have observed.<sup>35</sup>

<sup>30</sup> <https://ceprlegal.files.wordpress.com/2016/08/rcep-draft-investment-text-india.pdf>

<sup>31</sup> <https://ceprlegal.files.wordpress.com/2016/08/rcep-draft-investment-text-china.pdf>

<sup>32</sup> James Guthrie & Cynthia Ho, *Regime Shopping of IP Litigation and Enforcement from the Win to the International Investment Regime*, 18 Minn. J.L. Sci. & Tech. 427, 456 (2017).

<sup>33</sup> Martin Dierckx Branch, Phillip Morris v. Uruguay: all claims dismissed; Uruguay to receive US\$7 million reimbursement, <https://www.icsid.org/itu/2016/08/10/awards-and-decisions-24/>; Phillip Morris Brands Sdn. Bhd., Phillip Morris Products S.A. and Abal Hermonos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, para. 592, <https://www.itlaw.com/sites/default/files/case-documents/financ2417.pdf>

<sup>34</sup> PHILLIP MORRIS BRANDS SARI, Phillip Morris Brands SARI, supra note \_\_, at Phillip Morris seeking, in addition to damages and other appropriate relief, “all of their fees and expenses, including attorney’s fees, incurred in connection with this arbitration”.

<sup>35</sup> Guthrie & Ho, supra note \_\_, at 434.

In sum, despite some agreement on the investor-state dispute resolution, RCEP is the site of several disputes largely between Japan and South Korea, on the one hand, and India on the other, over the ability of India to continue to produce generic medicines for the poor. As evidenced from the leaked draft, India, joined often by various other RCEP partners, has sought to rebuff Japanese and South Korean demands.

Public health advocates around the world have urged India not to forsake the world's poor as it negotiates the RCEP not only on behalf of its own citizens and corporations, but also on behalf of nations across the world in the RCEP negotiations. The non-profit group Medicines Sans Frontières estimates that nearly 80% of all anti-retrovirals used in Africa come from India.<sup>36</sup> South African Health Minister Aaron Mosisoledi has labelled India “the pharmacy to the developing world.”<sup>37</sup> Mosisoledi urges, “My message to India is that we really rely on them and if they reverse their position now they will end up killing a lot of people in Africa...<sup>38</sup> India had been particularly critical to South Africa's battle against AIDS, which by 2001 had become the leading cause of death in that country. Yusuf Hamied, chairman of Cipla Pharmaceuticals, India's largest generic drug-maker, to the relief and surprise of the world announced a generic version of anti-retrovirals that would cost less than \$1 a day. Remarkably, the availability of the Indian generics brought the price of first-generation AIDS drugs down by 99 percent.<sup>39</sup> These medicines helped the price of HIV treatment in South Africa make the incredible drop from more than \$10,000 a person a year in 2000 to just over \$100 in 2016. This has enabled more than 17-million people in the developing world to receive HIV treatment,” writes Doctors Without Borders. “Today, 97% of the medicines Doctors Without Borders (MSF) uses to treat nearly 230,000 people with HIV are generic antiretrovirals from India.”<sup>40</sup>

The key to India's rise as a generic drug powerhouse was a crucial reform to India's patent law in 1970. The 1911 colonial-era patent statute had required patents in all fields in technology and in drug products and processes. After Indian Independence, a study of the social and economic effects of the patent law concluded that the colonial law was not tailored to promote India's economic or humanitarian interests as its chief beneficiaries were foreigners, who outnumbered Indians nine to one in obtaining patents. At the same time, the benefits of innovation were being priced out of the reach of most Indians, who were too poor

<sup>36</sup> <http://scroll.in/article/745344/why-south-africas-health-minister-is-so-worried-about-india-caring-in-to-big-pharma>.

<sup>37</sup> <https://internationalreportingproject.org/stories/view/why-south-africas-health-minister-is-so-worried-about-india-caring-in-to-big>

<sup>38</sup> *Ibid.*

<sup>39</sup> <http://bhaskara.org/article/2016-07-07-south-africa-must-stand-firm-with-india-the-pharmacy-of-the-developing-world> (author Clare Waterhouse is an access campaign officer for Doctors Without Borders (MSF) in Southern Africa).

to pay monopoly prices on medicines. “Patent systems,” Indian Supreme Court Justice N. Rajagopala Ayyangar, wrote in the study, “are not created in the interest of the inventor but in the interest of national economy,” and “to secure the benefits thereof to the largest section of the public.”<sup>41</sup> The Indian Patent Act of 1970 thus recognized patents in breakthrough chemical processes to make new drugs, but not in drug products themselves. This was, in fact, a common approach taken by many European countries at the time. The crucial decision to exclude product patents permitted a company to reverse engineer a drug product, to learn its underlying composition and technology, and to ultimately make the same drug, albeit in a different way. This spurred India's generic drug industry. India also became one of the largest exporters of generic drugs throughout the world, including to the United States.

But India's entry into the World Trade Organization (WTO) in 1995 put these provisions at risk. TRIPS requires members to recognize patents in any inventions, whether products or processes, in all fields of technology. When India amended its law in 2005, the legislature sought to utilize flexibilities within TRIPS to help generic drug manufacturing. Key to this was setting a high standard for patentability. The Indian Patent Amendment Act of 2005, for example, prohibits patents on mere modifications or tweaks on existing patents, thereby preventing what have come to be known as “evergreen” patents, where drug companies sought to extend their patents on weak grounds.

There is evidence that some efforts to place TRIPS-plus commitments in RCEP have been rebuffed during the course of the negotiations. In an earlier 2014 draft of RCEP, Japan had sought to eliminate the ability of a country to challenge a patent “solely on the ground that the invention is a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or that the invention is a new use for a known substance.”<sup>42</sup> That proposal is absent from the 2015 draft text, perhaps because it would have contradicted India's strict approach to patentability. In a widely-cited case, India denied Novartis a patent on a new salt form of Gleevec, its blockbuster cancer drug, on the ground that the salt form was a mere modification of the old patented technology, without therapeutic benefit. Novartis had argued that some 40 countries had granted patents on the salt form of Gleevec, and that India's patent standard was unfairly high. The Indian Supreme Court in 2013 affirmed the denial of Novartis's patent, finding that Congress had sought through the patent law to prevent abusive practices such as “evergreening” by pharmaceutical companies. The Indian Supreme Court delivered its judgment cognizant “that an error of judgment ... will put life-saving drugs beyond the reach of the multitude of ailing

<sup>40</sup> N. Rajagopala Ayyangar, Report on the Revision of the Patent Law, Gov't of India (1959).

<sup>41</sup> Behrns, Townsend et al., *The Regional Comprehensive Economic Partnership, Intellectual Property Protection, and Access to Medicines*, 28 Asia Pacific J. Pub. Health 682 (2016).

humanity not only in this country but in many developing and under-developed countries.”

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## II. Accidental Beneficiaries of RCEP: U.S. and European Multinationals

It may come as a surprise to some of the ASEAN, Chinese, Indian, Japanese, and South Korean negotiators that by negotiating TRIPS-plus provisions in RCEP, they are automatically granting those TRIPS-plus rights to United States and European companies. This is because, like GATT and GATS, the other principal WTO agreements, TRIPS contains most-favored-nations (MFN) and national treatment obligations. However, unlike GATT and GATS, TRIPS does not broadly exempt bilateral and regional free trade agreements from the application of MFN and national treatment. One expert pithily describes this as “regionalizing in GATT/GATS and multilateralizing in TRIPS.”<sup>42</sup> Joost Pauwelyn demonstrates this principle by applying it to the US-Chile FTA: “[M]y IP benefit conferred regionally between, for example, the US and Chile, must be extended automatically to all WTO members.”<sup>43</sup>

<sup>42</sup> Marco M. Alemán, *Impact of TRIPS-Plus Obligations in Economic Partnership and Free Trade Agreements on International IP Law*, EU Bilateral Trade Agreements and Intellectual Property: For Better or Worse 61, 68 (2014); *id.* at 83 (“TRIPS-plus provisions are immediately and unconditionally multilateralized through the MFN clause of TRIPS, which does not include the regional exception that exists for concessions concerning trade in goods and services.”). During the Uruguay Round negotiations, the European Communities proposed a regional trade agreement exception to the most-favored-nations and national treatment obligation. MTN.GNG/NG11/W/68/20 Mar. 1990, Art. 4 of the draft Agreement on Trade Related Aspects of Intellectual Property Rights submitted for circulation by the European Communities; MTN.GNG/NG11/W/70, 11 May 1990, Draft Agreement on Trade Related Aspects of Intellectual Property Rights submitted by the US, “except for any advantage, favor, privilege, or immunity which exceeds the requirements of this Agreement and which is provided for in an international agreement to which the contracting party belongs, so long as such agreement is open for accession by any contracting party of this Agreement.” (art. 3). Developing countries were skeptical of the need to include an MFN principle in the text. Meeting of the Negotiating Group of 1 November 1990, MTN.GNG/NG11/27, 14 Nov. 1990, paras. 3-4 (“Speaking on behalf of a number of developing countries, a participant ... said that he was still not convinced of the need to include the mfn principle in the text, since it was alien to the intellectual property system, and would in any case be rendered meaningless by the growing list of exceptions written into it.”).

<sup>43</sup> Joost Pauwelyn, Legal avenues to ‘multilateralizing regionalism’: Beyond Article XXIV, in Richard Baldwin & Patrick Low (Eds.), *Multilateralizing Regionalism: Challenges for the Global Trading System* 368 (2009). See also Bryan Mercurio, TRIPS-Plus Provisions in FTAs: Recent Trends, in Regional Trade Agreements and the WTO Legal System 215, 225 (Lorand Baris & Federico Ortino, eds. 2006) (“[I]f the US and a developing country member negotiate an FTA, MFN will force the developing nation to make the same IP concessions it accepted in the FTA available to all nations.”).

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The specific obligations are as follows. Under MFN, “[w]ith regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members....”<sup>44</sup> Under national treatment, “Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection<sup>3</sup> of intellectual property.”<sup>45</sup> A footnote makes clear that the national treatment and MFN obligations apply not only to intellectual property rights, but also to their enforcement: “For the purposes of Articles 3 [national treatment] and 4 [MFN], ‘protection’ shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement.” In United States – Section 211 Omnibus Appropriations Act of 1998, the Appellate Body agreed with the Panel that the appropriate standard to apply under Article 3.1 of TRIPS was whether a measure provided “effective equality of opportunities” to non-nationals.<sup>46</sup> The result is plain: if China, India, Indonesia, and Thailand agree to strengthen intellectual property rights vis-à-vis each other and for their own nationals within RCEP, they have automatically agreed to offer the same stronger rights to American and European corporations.<sup>47</sup>

Thus, *the greatest beneficiaries of the RCEP intellectual property chapter are likely to be U.S. and European companies*. Those companies, after all, have the greatest stock of intellectual property to be protected.<sup>48</sup> In promoting TRIPS-plus provisions in RCEP, the South Korean and Japanese governments are effectively arguing on behalf of U.S. and European enterprises.

An additional irony: Chinese, Indian, Japanese, and South Korean companies are not guaranteed reciprocal rights in Europe or the United States. Any rights granted in those jurisdictions depend on their own laws and TRIPS-plus commitments, not on the rights given in RCEP. Thus, the RCEP intellectual property chapter makes US and European corporations free riders—benefiting from its provisions, without their home jurisdictions facing any additional obligations.<sup>49</sup>

<sup>44</sup> TRIPS, supra note \_\_\_, at art. 4.

<sup>45</sup> TRIPS, supra note \_\_\_, at art. 3(1).

<sup>46</sup> Panel Report, United States – Section 211 Omnibus Appropriations Act of 1998, ¶ 8.131, WT/DS176/R (August 6, 2001), see Appellate Body Report, United States – Section 211 Omnibus Appropriations Act of 1998, ¶ 258, WT/DS176/AB/R (January 2, 2002) (adopted text 1, 2002).

<sup>47</sup> The MFN and national treatment obligation would not extend to the investor-state dispute resolution chapter.

<sup>48</sup> See supra notes \_\_\_, and accompanying text (describing global intellectual property royalty receipts, by country).

<sup>49</sup> Focusing on United States efforts to establish TRIPS-plus provisions in its free trade agreements, Ruth Mayne observes that “the EC in effect is able to free-ride on the US bilateral strategy though

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Skeptics may ask: If this process is indeed the case, then what explains the United States' zealous promotion of TRIPS-plus provisions in its free trade agreements? The answer may lie in the fact that, by and large, the United States is promoting provisions that are already part of its law. Thus, the addition of free trade agreement obligations does not in fact expand United States obligations to nationals of other WTO members because those foreign nationals already can claim those benefits by operation of national treatment.<sup>50</sup>

The advantages to be extended under the MFN and national treatment obligations are mandated, in both cases, only with respect to "the protection of intellectual property."<sup>51</sup> This narrows these obligations somewhat as TRIPS defines "intellectual property" as "all categories of intellectual property that are the subject of Sections 1 through 7 of Part II" of TRIPS. Those particular sections protect copyright and related rights, trademarks, geographical indications, industrial designs, patents, designs of integrated circuits, and undisclosed information. Thus, any part of the RCEP intellectual property chapter that does not protect those forms of intellectual property is not immediately available to nationals of all other WTO member states by operation of either MFN or national treatment. For the most part, however, the RCEP intellectual property chapter tracks the categories of TRIPS, so the bulk of the chapter would likely be subject to the MFN and national treatment obligations.<sup>52</sup> The RCEP proposals on plant variety protection and on genetic resources, traditional knowledge, and folklore<sup>53</sup> prove an exception to this rule because they have no TRIPS counterpart; thus, they would not be subject to the MFN and national treatment obligations.

Yet another exception to the MFN obligation (but not the national treatment obligation) can be found in free trade agreements pre-dating TRIPS, and duly notified to the TRIPS Council. This includes the intellectual property provisions in NAFTA, MERCOSUR, and the European Union (formerly

the Most Favoured Nation (MFN) provision in TRIPS." Ruth Mayne, Regionalism, Bilateralism, and "TRIPS Plus" Agreements: The Threat to Developing Countries (2005) UNDP Human Development Report Office Occasional Paper at 11. Europe can sit back and benefit from the sharp US negotiation, receiving "considerable commercial advantage without having to face the kind of inter-national prohibition faced by the US." Mayne insightfully notes, *Id.* Mayne may not have anticipated that both Europe and the United States might be able to free-ride on Korean and Japanese efforts to achieve stronger protections in Asia.

<sup>50</sup> Mercuro, *supra* note \_\_\_, at 220 ("It is ... clear that the TRIPS-Plus provisions appearing in US FTAs ... are identical to aspects of its domestic law.... [T]he US law providing the President with the power to conclude trade agreements ... [states as negotiating objective] an IP regime that reflect[s] a standard found in United States law."<sup>51</sup>

<sup>51</sup> Whether some provisions are covered by TRIPS "intellectual property" will prove controversial in certain cases. For example, whether TRIPS requires data exclusivity has been subject to debate. Chaspo Osoveo, *Data Exclusivity and Public Health Under the TRIPS Agreement*, 23(2) J. L. Information & Soc. 106, 111-12 (2014).

<sup>52</sup> RCEP, *supra* note \_\_\_, at art. 5.19 (new varieties of plants); *id.* at art. 7.1 (genetic resources, traditional knowledge, and folklore).

European Communities), which have all been notified to the WTO.<sup>55</sup> However, because the grandfather exclusion does not apply to national treatment, TRIPS-plus obligations in these regional arrangements will still be multilateralized through WTO member states because of the national treatment obligation.

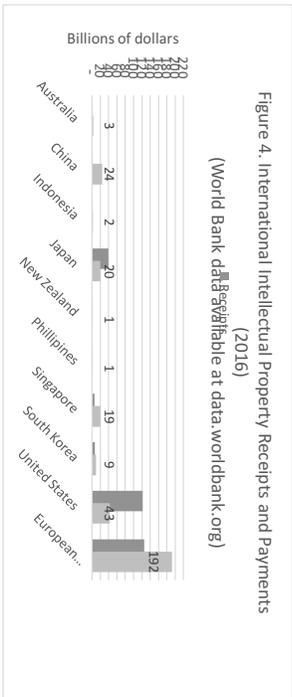
Strong intellectual property protections in RCEP benefit U.S. and European companies in yet additional ways. First, as other nations in Asia join the RCEP, they will be required to accept the existing intellectual property protections in the agreement. Second, it will be difficult for the RCEP nations to reject such strong provisions in any future trade agreement with Europe or the United States when they have accepted them in such agreements already (and they are already effectively applicable to European and United States companies via the national treatment and MFN obligations). Third, such provisions will reduce the ability of the RCEP nations to manufacture generic medicines for either domestic use or export.

Stronger intellectual property rights are likely to benefit the United States most of all, if past international intellectual property payments are a guide. The RCEP nations lag far behind the United States and the EU in receiving international payments on intellectual property, as Figure 4 shows. While RCEP has been described as a counterweight to the United States, in fact, the intellectual property provisions in RCEP may ultimately benefit U.S. and European companies. The European Union and the United States receive the great bulk of international royalties on intellectual property, some 125 billion and 122 billion dollars respectively in 2016, according to World Bank statistics.<sup>54</sup> Japan receives but a fraction of this amount, some 39 billion dollars, and South Korea even less, at less than 7 billion dollars, and the other RCEP countries report much smaller amounts, and some do not collect such statistics at all.<sup>55</sup> South Korea and even the European Union, in fact, pay out more than they receive in international intellectual property payments.

<sup>53</sup> The U.S. only notified to the TRIPS Council a single article of NAFTA, while Mexico notified all of NAFTA's intellectual property provisions. United States, Notification Under Article 4(b) of the Agreement, IP/N/4/USX/1 (Feb. 29, 1996); Mexico, Notification Under Article 4(b) of the Agreement, IP/N/4/MEX/1 (Feb. 12, 1996). The European Communities' notification seeks to exclude not only existing rights, but also "future acts adopted by the Community as such and/or by the Member States which conform with these agreements following the process of regional integration." European Communities and their Member States, Notification Under Article 4(b) of the Agreement, IP/N/4/EEC/1 (29 January, 1996). The notification from Mercosur (established by the Treaty of Asuncion in 1991) follows this model as well, covering "all agreements, protocols, decisions, resolutions and guidelines adopted or to be adopted in the future by MERCOSUR or its States Parties." WTO IP/N/4/AMG/1, IP/N/4/BRCV/1, IP/N/4/PRV/1, IP/N/4/URY/1, 14 July 1998.

<sup>54</sup> <http://data.worldbank.org/indicator/BXGSRROYL.CD?view=map>.

<sup>55</sup> *Id.* See in *fra* notes \_\_\_, \_\_\_, and accompanying text.



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### III. Conclusion

The negotiation of an Asia-Pacific trade agreement represents an opportunity for developing and recently developed countries to set a new agenda for intellectual property—one focused not just on protecting property rights, but on ensuring access to medicine and access to knowledge. At present, RCEP fails to make a start towards such goals, and, if some parties prevail in the negotiation, will in fact impede them. Countries in the region could instead agree to a new funding mechanism to fund treatments for the diseases of the developing world—perhaps borrowing as inspiration the newly-established Asian Infrastructure Investment Bank. Scholars have increasingly recognized the usefulness of prizes and grants as a mechanism to spur innovation along useful lines.<sup>56</sup> If it includes an intellectual property chapter at all, RCEP should create a new model of intellectual property agreement, devoted not to promoting intellectual property first and foremost and for its own sake, but to promoting health, education, and innovation. The sixteen countries negotiating RCEP should either withdraw or rewrite the intellectual property chapter of that agreement.

<sup>56</sup> See, e.g., Ganitha A. Hardy, *Patent Nationality, Immune Liability*, 31 BERKELEY TECH L.J. 1301 (2017) (discussing use of local public finance alternatives to intellectual property); Daniel J. Hend & Lisa Larromore Ouellette, *Beyond the Patents—Prize Debate*, 92 TEX. L. REV. 303 (2013) (comparing various schemes to promote innovation, including patents, prizes, grants, and tax incentives); Brett Frischmann, *Innovation and Institutions: Rebalancing the Economics of U.S. Space and Technology Policy*, 24 VT. L. REV. 347 (2009). The principal criticism of prize and grant mechanisms as an innovation tool is that governments lack sufficient information to guide innovation. But if the governments' goals are well-defined—say to develop cures for a particular illness, or to improve methods to deliver medicines, say, in tropical climates—this particular defect can be ameliorated.

# Regional Comprehensive Economic Partnership (RCEP): Progress and Challenges

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## I. Introduction

The Regional Comprehensive Economic Partnership (RCEP) is an ongoing free trade agreement involving ASEAN member states (AMSs) and six trading partners: Australia, China, India, Japan, South Korea and New Zealand.<sup>1</sup> In the last few years, the RCEP was negotiated in parallel and recognized as a competitor to another mega trade deal, the Trans-Pacific Partnership (TPP). The ASEAN-led trade deal is now in the spotlight after President Trump's decision to withdraw the United States from the TPP.

This article examines the progress and challenges of the RCEP, then discusses the implications and prospects of the negotiation. Through this work, we can re-evaluate the economic significance of the RCEP amid growing protectionism in the Asia-Pacific region.

<sup>1</sup> The six countries are referred to as ASEAN FTA Partners (AFPs) throughout this article.

## II. Progress of RCEP

### Background of RCEP

The current ASEAN+6 framework was originally proposed by Japan, in competition with the ASEAN+3 framework suggested by China.<sup>2</sup> Despite this disagreement between the regional frameworks proposed by China and Japan, ASEAN proposed the RCEP to assume leadership of the group and respond to the evolution of the CJK FTA and TPP.<sup>3</sup>

RCEP participating countries (RPCs) have already signed bilateral and multilateral FTAs with the member countries. Other than the ASEAN+1 FTAs,<sup>4</sup> RPCs have concluded bi-

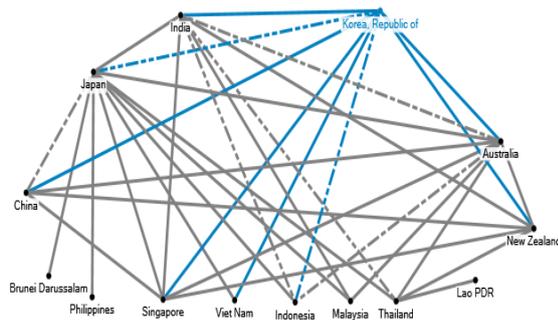
<sup>2</sup> ASEAN+3 means ASEAN and three of its trading partners, China, Japan, South Korea (CJK). Hamanaka (2014) interprets that Japan proposed including Australia and India to dilute China's influence within the region.

<sup>3</sup> It is plausible that China accepted the RCEP in order to compete with the US-led TPP even though the RCEP adopted the ASEAN+6 framework. (Hamanaka, 2014).

<sup>4</sup> These include the ASEAN and China Free Trade Agreement (ACFTA), ASEAN and Korea Free Trade Agreement (AKFTA), ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEP), ASEAN-India Free Trade Agreement (AIFTA), and the ASEAN-Australia and New Zealand Free Trade Agreement (AANZFTA).

lateral FTAs between members, such as the Korea-Vietnam FTA, India-Malaysia CECA, Japan-Indonesia Economic Partnership Agreement, and China-Thailand FTA. Figure 1 represents the bilateral FTAs concluded or under negotiation in the region.

**Figure 1. Existing FTAs within RCEP Bloc**



Note. 1) ASEAN+1 FTAs are excluded in the figure.  
2) Dotted lines represent the FTAs under negotiation.  
Source: Asia Pacific Trade and Investment Database (ESCAP)

Since RPCs have already established overlapping FTAs with member countries, the effect of trade creation from the RCEP is not expected to be large. However, the agreement can improve the efficiency of regional production networks through the harmonization of existing FTAs and trade rules such as the rules of origin (ROO). To induce economically meaningful gains from the RCEP, it needs significant improvements over the existing ASEAN+1 FTAs, as indicated in the Guiding Principles of the RCEP. If these improvements are not realized, the RCEP will become nothing more than a mere collection of the existing ASEAN+1 FTA texts.

### Guiding Principles and Objectives

RCEP negotiations cover trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, e-commerce, and other issues.

According to the Guiding Principles endorsed in August 2012, RCEP negotiations will follow eight principles: (1) consistency with the WTO; (2) significant improvements over the existing ASEAN+1 FTAs; (3) facilitation of trade and investment; (4) flexibility (e.g., special and differential treatment) to the least-developed AMSs; (5) continuation of existing FTAs; (6) open accession clause; (7) technical assistance and capacity building to the developing and least-developed countries; and (8) parallel negotiation.

A notable aspect is that the RCEP emphasizes “ASEAN centrality” and tries to achieve significant improvement over the ASEAN+1 FTAs with limited deviation. From that, it is expected that the starting point of RCEP negotiations would be the existing ASEAN+1 FTAs.

### Current Status

RCEP negotiations were launched in November 2012, and 18 rounds of negotiation have been held, along with six ministerial meetings and three intersessional meetings. Two chapters, namely “Economic and Technical Cooperation” and “Small and Medium-sized Enterprises,” have been concluded, and other chapters are still in progress with some of them nearing conclusion.<sup>5</sup>

To date, progress in the RCEP negotiations has been sluggish due to disagreement over the modality of tariff reduction on trade in goods, liberalization of services, and investment framework. In regard to trade in goods, it is known that the proportion of products committed to eliminate tariffs has not been

<sup>5</sup> Refer to “Joint Media Statement, the 3rd RCEP Intersessional Ministerial Meeting.”

finalized yet.<sup>6</sup>

While the RCEP has struggled balancing the interests of participants and missed its conclusion target twice, it still keeps its momentum moving forward, especially this year, which marks the 50th anniversary of ASEAN's founding. Leaders noted in a joint statement of the 3rd RCEP intersessional Ministerial Meeting held in May 2017 that "the substantial conclusion of the RCEP has been identified as a priority deliverable in this milestone year of ASEAN's 50th anniversary."

### III. Major Issues

#### Trade in Goods

The main issues of trade in goods are (i) coverage of tariff elimination, and (ii) adoption of common concession.

**Table 1. Tariff Elimination Coverage by Country under ASEAN+1 FTA**

	Unit: %					
	AANZFTA	ACFTA	AIFTA	AJCEP	AKFTA	Average
Brunei	99.2	98.3	85.3	97.7	99.2	95.9
Cambodia	89.1	89.9	88.4	85.7	97.1	90.0
Indonesia	93.7	92.3	48.7	91.2	91.2	83.4
Laos	91.9	97.6	80.1	86.9	90.0	89.3
Malaysia	97.4	93.4	79.8	94.1	95.5	92.0
Myanmar	88.1	94.5	76.6	85.2	92.2	87.3
Philippines	95.1	93.0	80.9	97.4	99.0	93.1
Singapore	100.0	100.0	100.0	100.0	100.0	100.0
Thailand	98.9	93.5	78.1	96.8	95.6	92.6
Vietnam	94.8	-	79.5	94.4	89.4	89.5
Australia-New Zealand	100.0					
China		94.1				
India			78.8			
Japan				91.9		
South Korea					90.5	

Note: HS2007 version, HS 6-digit base.

Source: Fukunaga and Isono (2013)

<sup>6</sup> Sanchita Basu Das (2017)

As shown in Table 1, AMSs have committed to eliminate tariffs on around 91 percent of products in the existing ASEAN+1 FTAs on average, but each member state takes a different commitment level across the FTAs. AMSs except Cambodia and Singapore allow the lowest tariff elimination rate in AIFTA, and India allows the lowest level of tariff elimination among the AFPs. It is expected to be difficult to reach the agreed parameter due to the differences in market openness among participating countries.

Also, the issue of "common concession" is known as an impediment to the RCEP negotiation. In the case of ASEAN, the products committed to eliminate tariffs in all ASEAN+1 FTAs are only 73.3% on average, making it difficult to adopt a common tariff applied to all of the participating countries.

**Table 2. Distribution of Tariff Lines by Liberalization Status**

	Unit: %		
	% of eliminated to all products	% of depends on FTA products	% of protected to all products
Brunei	84.1	15.9	0
Cambodia	64.3	35.3	0.4
Indonesia	46	52.8	1.2
Laos	68	31.6	0.4
Malaysia	76	22.9	1.1
Myanmar	66.6	31.8	1.6
Philippines	74.6	24.4	1
Singapore	100	0	0
Thailand	75.6	24.3	0.1
Vietnam	78.1	19.1	2.8
Average	73.3	25.8	0.9

Source: Fukunaga and Isono (2013)

Also, it is known that India had proposed a 3-tier approach that presents different tariff reductions by country. According to Cote and Jena (2015), India would provide a reduction

of 80 percent of tariff lines to ASEAN countries, 65 percent to Japan and South Korea, and 42.5 percent to Australia, New Zealand and China, with which India does not currently have an FTA.

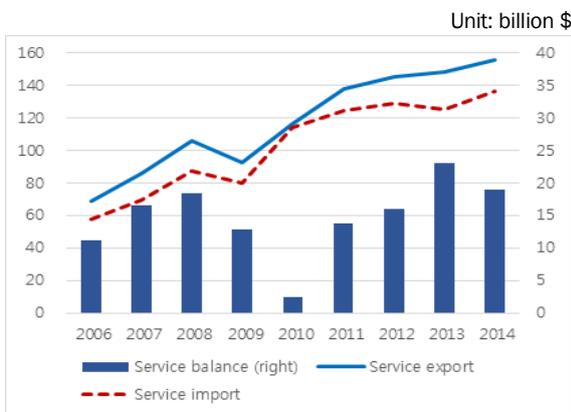
The comparative advantages of the member countries are different for each trading partner, and thus there are incentives to take different tariff schemes accordingly. However, if tariff schedules are different for each country, the increasing complexity could make it difficult to utilize the FTA. Failure to adopt a common concession would mean the implementation of multiple tariff elimination schemes by 16 parties, leading to a “noodle bowl” situation.

The common concession issue was intensely discussed at the 2nd Intersessional Ministerial Meeting held in Cebu, 2016, and is still under discussion.

### Trade in Services

India believes that there is little to be gained through the liberalization of trade in goods, but much to be gained through higher levels of commitment in trade in services.

Figure 2. India's Service Trade against World



Source: UN Comtrade

It is known that India would make further

commitment in goods conditional on liberalization of trade in services, for example by opening up Mode 4, movement of natural person.

### Other Issues

Investor-state dispute settlement (ISDS) has been known to be a controversial issue in the investment chapter, and data exclusivity, patent term extension are known as contentious issues in the Intellectual Property Rights (IPR) chapter.

## IV. Outlook and Implications

It is hard to balance the interests of RPCs due to the different industrial structures and levels of development among participating countries. Since the negotiations on trade in goods, trade in services, investment and other areas are being conducted in parallel, it is not easy to speed up discussion given the complexities. It seems unrealistic to expect conclusion of the RCEP by the end of this year, but it is likely that considerable progress will be made during ASEAN's 50<sup>th</sup> anniversary.

With the global trade slowdown, the importance of the RCEP to keep markets open and deepen integration is increasing. RPCs should continue their efforts to reach high-standard and economically meaningful outcomes. The agreed outcome should be able to reduce intra-regional transaction costs through simplification and harmonization of rules of origin, customs procedures and standards.

Once the RCEP is concluded in the absence of the TPP, it can affect the regional value chain. Thus, proactive strategies based on the changed GVCs must be developed. **KIEP**

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## ARGUMENT

# It's Time to Think for Yourself on Free Trade

What economists and populists both get wrong about the international economy.

BY **DANI RODRIK** | JANUARY 27, 2017, 7:57 AM

**E**conomists like to claim that the purpose of free trade is to eliminate barriers that impair the efficient global allocation of resources, while helping some of the world's poorest people. It's an argument undermined by a simple thought experiment. Suppose we wiped the slate clean of the Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership, and other similar trade deals, and the world's trade negotiators banged their heads to figure out the best way of achieving their stated goals. What would they be negotiating about?

Tariffs? Rules on intellectual property rights? Investment regulations?

None of the above. They would go instead after barriers to international labor mobility and try to hammer out a deal over some kind of temporary work visa plan, along the lines I describe in an academic paper I recently **published**. There is practically nothing that would do more to enlarge the economic pie (nationally and globally) while improving the global distribution of income.

Of course, anything like that would be wildly unrealistic in the current political climate. But I bring up the thought experiment to illustrate that trade negotiations are only loosely about what they purport to be about: enhancing economic efficiency and economic opportunities. The problem with the present trade regime is not that it sacrifices the political and the social for the economic; it is that it has never made much sense from the economic perspective, either. Which is why it's a mistake to judge real-world trade agreements strictly on economic terms, rather than social or political ones.

In some sense we all know this. Consider another thought experiment: Suppose Harry and John own two companies that compete with each other. How do you feel about each of the following four cases?

1. Harry works really hard, saves and invests a lot, comes up with new techniques, and outcompetes John, resulting in John and his employees losing their jobs.
2. Harry gets a competitive edge over John by finding a cheaper supplier in Germany.
3. Harry drives John out of business by outsourcing to a supplier in Bangladesh, which employs workers in 12-hour shifts and under extremely hazardous conditions.
4. Harry "imports" Bangladeshi workers under temporary contracts and puts them to work under conditions that violate domestic labor, environmental, and safety laws.

From a purely economic standpoint, these scenarios are what economists call “isomorphic” — they are formally indistinguishable because each creates losers as well as winners in the process of expanding the economic pie in the national economy. (That is, Harry’s gains are larger than John’s losses.)

But most people react very differently to these scenarios. The manner in which the gains and losses are generated matter to them. In particular, scenarios 3 and 4 appear problematic insofar as they produce competition that violates ground rules that have been set at home.

Furthermore, scenario 4 would be clearly illegal, but no different in its practical consequences from scenario 3. This raises the question of why we should be OK with scenario 3, while most observers would regard 4 as unconscionable.

The point of this second thought experiment is to suggest that certain kinds of international competition can undermine domestic norms with regards to what’s an acceptable redistribution. A similar thing happens when competition from tax havens undermines a domestic tax regime, or when imports from jurisdictions with poor safety enforcement undermine domestic consumer safety rules.

It’s important to distinguish between two versions of an argument as to why trade may be problematic from a social or political perspective. Some suggest trade is problematic because it redistributes income. The basis for that claim is true, but trivial. Pretty much everything else that happens in a market economy somehow redistributes income. Technology and market competition are the sources of endless churns in an economy. Moreover, plenty of other things, including skill-biased innovation and minimum-wage laws, have vastly greater effects on income distribution than trade.

So it makes very little sense to set international trade apart and decouple it from other domains or approaches for dealing with inequality in labor markets at large (progressive tax systems, active labor market policies, employment-friendly macro policies, etc.). Imports from Germany may adversely affect domestic companies that are displaced, but there’s no reason to treat the people who lose out any differently from workers who are adversely affected by, say, technological innovation. There is a coherent justification for compensating the losers of free trade for reasons of solidarity and equity, but the justification would apply in the case of innovation. Consequently, the preferred remedies should be the same as well.

That brings us to a different social and political objection to trade — that trade violates norms embodied in our institutional arrangements. The suggestion here is that trade may undercut the social bargains struck within a nation and embedded in its laws and regulations.

This argument corresponds to scenario 3 in the thought experiment above. In that case, compensating the losers would be beside the point, because what is at stake is the surreptitious modification of the rules of the game — the undermining of domestic social bargains through the back door. Trade is not merely a market relationship, but an intervention into domestic institutions and an instrument for reconfiguring them to the detriment of certain groups. It would

be entirely legitimate to respond to such an injury by directly curtailing the trade flows that have the alleged effect. After all, this is no different from keeping out imports that violate, say, domestic health and safety regulations, which most countries already do.

And this brings us to “fair trade.” Fair trade is much derided by economists who view it as a thinly disguised cover for self-interested protectionism. But it is already enshrined in trade laws (in the form of anti-dumping and safeguard remedies), although in a very skewed, corporation-friendly way.

So rather than abandon the fair trade concept, we should broaden it, as it exists in trade law, to include social dumping — cases, like scenario 3, which undercut domestic social arrangements. Just as countries can impose duties on goods that are sold below costs, they should be allowed to restrict imports that demonstrably threaten damage to domestic regulatory arrangements. (I discuss what such a process may look like in the concluding chapter of my book [The Globalization Paradox](#). And, no, this would not open the trade regime to more protectionist abuse than anti-dumping practices already do!)

The benefit of thinking about fair trade along these lines is that it allows the drawing of a clear line between trade flows that threaten legitimate domestic political arrangements and those that don't. For example, there is a clear distinction between situations where a trade partner's low wages are due to low productivity, and the abuse of worker rights (including, say, the absence of collective bargaining, or freedom of association). Both may generate distributional implications at home, but there is a problem of unfair trade only in the second case.

Economists should be more willing to accept that trade may fail to pass the fairness or legitimacy test in certain circumstances. Paradoxically, this would strengthen their defense of international trade in the bulk of cases where the test is easily passed. It would enable them to speak to popular concerns about fairness in trade without undermining the general case for trade.

By refusing to acknowledge the possibility of social dumping — and failing to put in place remedies for it — the trade technocracy has opened the door to populists and demagogues on trade. It has allowed trade in general to come under attack instead of the specific problematic flows that probably constitute a very small share of imports. It is [a clear instance](#) of trade purists damaging their cause.

Some regional trade agreements take social dumping concerns on board, but trying to “improve” other countries' labor, environmental, or social standards through trade agreements is generally ineffective — and also misguided to the extent that it puts commercial interests in the driver's seat of what is a deeper developmental problem. There is an important difference, often eluded in fair trade discussions, between using trade policy to prevent the undermining of domestic standards, and the use of trade policy to export our standards to other countries. The first is legitimate, the second much less so.

Even if we care about human rights, labor standards, and environmental safeguards in other countries, we should pursue these goals in other international forums, dedicated to these goals,

and not through trade deals. If Vietnam has a labor problem, let us not delude ourselves that we can fix it through the TPP. And if that problem threatens to undercut our labor standards, let's deal with that as an instance of social dumping, through domestic trade remedies.

It should go without saying that fair trade of this sort isn't anti-trade — quite the opposite. Globally, the principle of fairness should include leeway for poorer countries to grow their economies. That means not saddling them with the restrictive rules on intellectual property, industrial policies, capital-account regulations, and investor rights as current regional trade agreements typically do.

I recognize that such considerations leave me at odds with all the established strands of thinking on trade. Populists such as President Donald Trump have correctly identified the malaise with trade and have capitalized on it. But they greatly exaggerate the real-world significance of the “fairness” concern and seem determined to fix a surgical problem with a sledgehammer.

Meanwhile, economists rightly point out that trade is only weakly implicated in the major economic problems of the day — deindustrialization and income inequality. They are correct that the distributional consequences of trade are better addressed with safety net programs and nontrade remedies. But they have systematically downplayed these consequences — especially when the requisite compensatory programs have remained on paper. And they seem unable to grasp the valid core of the public's concern about social dumping.

Finally, progressive voices and their allies affiliated with the labor movement in the United States have been keenly aware of the potential for social dumping. But they want to fight it with revamped global governance measures that are at best ineffective and at worst the cause of populist backlash in the countries subjected to them.

Responding to the economic and political crises of our day requires that we restore a healthy balance between an open global economy and the prerogatives of the nation state. That requires us to be honest about trade's consequences — not just the economic opportunities they create for our businesses and consumers, but the stresses they generate for our social compacts.

Photo credit: JUSTIN SULLIVAN/Getty Images)

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## Why Doesn't Everyone Get the Case for Free Trade?

Free trade is not the natural order of things. We get free trade—or something approximating it—only when the stars are lined up just right and the interests behind free trade have the upper hand both politically and intellectually. But why should this be so? Doesn't free trade make us all better off—over the long run? If free trade is so difficult to achieve, is that because of narrow self-interest, obscurantism, political failure, or all of these combined?

It would be easy to associate free trade always with economic and political progress and protectionism with backwardness and decline. It would also be misleading, as we saw in the previous chapter. The real case for trade is subtle and therefore depends heavily on context. We need to understand not just the economics of free trade, but also its implications for distributive justice and social norms.

### Trade as Technological Progress

There is no better place to begin than in 1701, with a certain Henry Martyn. Martyn, a lawyer and Whig loyalist in early eighteenth-

century England, is now all but forgotten. Greatly ahead of his time, he produced, three quarters of a century before Adam Smith and more than a century before David Ricardo, the best argument for free trade known to men.<sup>1</sup>

Martyn thought the mercantilists who dominated thinking on economic policy had it all backwards on trade. The prevailing view held that Britain should import nothing but raw materials so that manufacturing could be reserved for domestic producers. There was great public opposition to the East India Company, which had started to import cotton textiles from India. Martyn thought otherwise. He felt imports of manufactures from India represented a benefit to the English nation rather than a loss.

Martyn wanted to set the mercantilists straight, but there was a problem. He was also interested in public office. He would eventually be appointed in 1715 as Inspector General of Imports and Exports, a post created as a result of the mercantilists' obsession with the volume of trade that required him to tally up England's inbound and outbound trade. Expressing free trade views in public would have damaged his political ambitions; such was the dominance of protectionist sentiment at the time. So when he penned his innocent-sounding but incendiary tract, *Considerations Upon the East-India Trade*, in 1701, he was compelled to do so anonymously.<sup>2</sup> In this remarkable pamphlet, Martyn anticipated many of the arguments that economists who favored free trade would marshal much later. Most impressively, he produced—with greater punch than most textbooks manage even today—the “killer argument” for free trade.

Martyn's argument relies on an analogy between international trade and technological progress. Martyn pointed to instances of technology that would have been familiar to the readers of his day. Take the sawmill, he wrote. The sawmill allows two people to do the work that in its absence would have required thirty people. If we reject the use of the sawmill, we could employ those thirty people, but wouldn't that be twenty-eight more than is really nec-

essary, and hence a waste of the nation's resources? Or consider a barge on a navigable river. Five men on the barge can transport as much freight as one hundred men and as many horses on land. If we neglect the river, we could put that many men and horses to work, but wouldn't that once again be a waste? Martyn assumed his readers would find it self-evident that it would be silly to give up on technological innovations such as the sawmill or the barge. Following the same logic, Martyn offered the clincher. Wouldn't it be a similar waste to employ workers in England if the textiles they produce can be obtained from India by putting fewer people to work?<sup>3</sup>

We can produce textiles at home; or we can obtain the same quantity of textiles from India by producing another commodity which we sell in exchange. If the latter takes less labor than the former, it is the same as if a better technology for supplying textiles has dropped from the sky. We wouldn't think of denying the nation the benefit of sawmills, barges, or any other labor-saving innovations. Isn't it equally silly to reject imports of manufactures from India?

Martyn's argument for free trade captures the essence of what trade accomplishes and it is rhetorically effective—who can seriously be against technological progress? When I confront my students with it, it doesn't take long before one of them will hone in on one of the problems with the argument. It assumes that the labor no longer employed in producing textiles at home will find employment in some other occupation. If the labor remains unemployed instead, the gains are no longer so obvious. But Martyn's analogy is immune to this challenge—at least in the first round. Technological progress is no different, as it too displaces labor and may result in transitional unemployment. If you are in favor of technological progress, you must be in favor of free trade!

There is one loose thread in Martyn's argument: even though it clarifies why trade benefits England, it fails to demonstrate why it should also benefit India. Why would India want to sell textiles

to England in return for British manufactures if India's textiles in fact take more labor to produce and would cost India more than what it was buying in exchange? The hole in the argument was not filled until David Ricardo produced his famous example of trade between England and Portugal in cloth and wine in 1817, and conclusively established the principle of comparative advantage. It is unlikely that Indian producers face identical conditions to those that prevail in England. If, compared to England, Indian producers are more productive in textiles than they are in the types of goods that English manufacturers produce, textiles will cost less in India than those English goods. Both countries will end up buying what is cheap abroad and expensive at home, economizing on the use of their labor in the way Murrin suggested. Trade benefits all sides; it is *not* zero-sum.

Significantly, there are mutual gains from trade even if India produces both sets of goods at lower productivity (higher labor costs) than England does. India need only be not as bad in textiles as it is in other manufactures. What creates comparative advantage is differences across nations in *comparative* costs, not in absolute costs.

This is a powerful argument and one that critics of free trade often fail to fully digest before taking it on. As Paul Samuelson once suggested in response to a challenge by a mathematician with little respect for the social sciences, it is probably the only proposition in economics that is at once true and non-trivial. "That it is logically true need not be argued before a mathematician," Samuelson said, "that it is not trivial is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them."<sup>4</sup> Fallacious reasoning often substitutes for intelligent commentary on trade. In a famous but apocryphal quote attributed to Abraham Lincoln, the Great Emancipator is supposed to have said:

I do not know much about the tariff, but I know this much, when we buy manufactured goods abroad, we get the goods and the foreigner gets the money. When we buy the manufactured goods at home, we get both the goods and the money.<sup>5</sup>

Of course this is exactly the kind of mercantilist fallacy that Murrin (and Adam Smith, David Ricardo, and Paul Samuelson after him) wanted to refute. The true cost of consuming a good is the labor and other scarce resources we have to employ to obtain it, not the money that facilitates the transaction.

### Public Skepticism on Trade

Such fallacies tend to make economists impatient with objections to free trade and dismissive of those who would want to interfere with it. It is easy to pooh-pooh many anti-trade arguments because they make little sense upon scrutiny. Yet among the general public, skepticism about trade is too widespread to dismiss so easily. Survey after survey finds that a distinct majority of people support restrictions on imports to "protect" jobs and the economy. The United States is hardly an outlier in this. For example, a global survey undertaken in the late 1990s found overwhelming support for trade protection: nearly 70 percent of the respondents in the global sample favored limiting imports.<sup>6</sup>

Within any given country, highly educated individuals tend to be less protectionist than others. Yet in many countries trade is hardly popular even among those groups. In the United States, for example, anti-trade feelings dominate two-to-one among individuals in the top one third of population with the highest education.<sup>7</sup>

Individuals who are likely to suffer income losses from the

expansion of trade are naturally inclined toward protection. But even though narrowly economic motives play a role, they are only partly responsible for the widespread opposition to trade. People with a strong sense of patriotism and communitarian attachments—to their neighborhoods, region, or nation—also dislike international trade, regardless of the type of jobs they hold or their educational level. Women are systematically less sympathetic to trade than men, even when their economic status and employment are similar. Values, identities, and attachments matter.<sup>8</sup> It is too facile to attribute anti-trade views to naked self-interest or sheer ignorance.

Could it be that ordinary people have a better intuitive sense of the complexity of the case for free trade than we give them credit for? In fact, powerful and elegant as it may be, the argument presented by Henry Martyn, David Ricardo, and others is not the whole story. Life as a trade economist would be pretty boring if it were so. Okay, maybe it's not as much fun as being Mick Jagger, but I can assure you that doing international economics as a living entails a lot more than reaffirming the wonders of comparative advantage day after day. Every advanced student of trade learns that there are a lot of interesting twists and turns to the tale of gains from trade. A long list of requirements needs to be in place before we can reasonably be satisfied that free trade improves a society's overall well-being. Sometimes less trade can be better than more trade. The analogy with technical progress can be misleading, in ways that illuminate why there is such a chasm between economists and common folk in public debate.

### The Case for Trade, Qualified

Recall Martyn's point: imports economize on the use of resources. It makes sense to import goods as long as it takes less labor to produce the exports that would pay for those imports than it does

to produce those goods ourselves. But how do we actually do the accounting for the labor costs that go into producing different goods—as well as for the other expenses for capital, skilled professionals, land, and so on? What is the appropriate metric?

Early theorists like Henry Martyn and Adam Smith were a bit too glib when they assumed that it was sufficient to look at actual production costs or the number of people employed. The costs that we face as individual consumers and producers are not always the relevant costs from the perspective of the nation as a whole.<sup>9</sup>

The true cost to society of labor (and other resources) used in an activity may be more or less than what the employer directly bears and the consumer pays for. Let's call the first "social" costs and the second "private" costs. Social costs exceed private costs, for example, when production generates harmful effects on the environment. It is the other way around when production generates valuable knowledge and other technological spillovers elsewhere in the economy. These are familiar instances of what economists call "negative" and "positive externalities," which drive a wedge between what is privately profitable and what is socially profitable.

Such wedges also exist when society values equity and other social considerations. When we care about the people at the bottom of the income distribution (and find it hard to increase their incomes directly), the social costs of employing poor or otherwise disadvantaged individuals will be less than the private costs. Consider the antebellum United States mentioned in the previous chapter. It is rather obvious that the expenses Southern slaveholders incurred in their export plantations failed to account for the catastrophic societal costs of slavery as a social and political regime.

In the economist's jargon, the resources used in international exchanges must be valued at their true *social opportunity costs* rather than at prevailing market prices. These two accounting schemes coincide only when markets internalize all social costs, distribu-

tional considerations can be shunted aside, and other social and political objectives are not at stake; they don't otherwise. The students who worried that Martyn overlooked unemployment were on to something. There is a wide range of situations, going far beyond transitional unemployment, in which free trade may not look as attractive once its full implications are appropriately evaluated.

Moreover, Martyn was wrong to imply that we always take a hands-off attitude toward technology. We sometimes close off specific avenues to scientific and technological progress—certain kinds of experiments on humans and human cloning, for example—because they conflict with deeply held values. Fields such as nuclear technology and genetic engineering remain tightly circumscribed in most countries. New drugs must go through a stringent and lengthy approval process before they are made available to consumers. Genetically modified crops are subject to detailed restrictions on planting practices when allowed at all. Technologies in many mature industries such as autos, energy, and telecoms are also heavily regulated for reasons of health, safety, and environmental impact, or to ensure widespread access. Legal requirements with respect to emissions, seat belts, and airbags, for example, have been a key force behind technological change in the auto industry.

On the flip side, we subsidize many forms of research and development because we believe they produce positive knowledge spillovers to the economy at large. Governments sanction temporary monopoly in the form of patents to induce innovation. They fund universities and research labs, and they consciously act to influence the direction of technological progress, pushing green technologies over others, for example. Technology is hardly a free-for-all.<sup>10</sup>

Ultimately, the analogy that Henry Martyn and his intellectual descendants employed is a useful one: free trade is indeed just like technical progress. But don't let the rhetoric fool you. The fact that we intervene so heavily in the process of technological

change should teach us something. If economics were only about profit maximization, it would be just another name for business administration. It is a *social discipline*, and society has other means of cost accounting besides market prices.

But what exactly does that mean for the conduct of trade policy? What kind of rules should we apply, and how do we prevent ourselves from sliding into unbridled protectionism—from turning into modern-day equivalents of Ned Ludd's followers during the Industrial Revolution, who opposed the spread of new textile technologies and destroyed mechanized looms? To answer these questions, we need to dig a bit deeper into trade's social consequences.

### Trade and Income Distribution

College students learn about the gains from trade not from Martyn, Smith, or even Ricardo, but from a diagram which is the staple of every introductory economics textbook. The professor draws a couple of demand and supply curves, points to where the market prices are with and without tariffs, and then asks how much the economy would gain from removing the tariff. He carefully labels areas representing income gain and loss to different groups in society: area A captures the loss to competing producers at home, area B the gain to domestic consumers, and area C the loss in tariff revenue for the government. And the "net" gain to the economy? He adds and subtracts all these areas as appropriate, and *voilà!* We are left with two triangles that represent the gains from trade to the economy—or equivalently the "deadweight loss" of the tariff. Here is why tariffs are a bad idea, and here is how much we gain by removing them.

It is a handy demonstration, and I must admit that I too take a certain pleasure whenever I go through these motions—the joy of bringing the uninitiated into the fold. No need to confuse the

students at this point by pointing out that the supply and demand curves we used to calculate the “net” gains are not necessarily the appropriate ones. The demand and supply schedules represent, respectively, “willingness to pay” and “marginal cost”—of the individual consumers and producers in that specific market. When private and social valuations diverge, neither of these will be a good guide to how much society is willing to pay or the costs society incurs. Even without that complication, however, the blackboard demonstration makes two important points obvious.

First, income redistribution is the other side of the gains from trade. If trade causes some activities to contract and others to expand—as it must if the full gains from trade are to be reaped—those groups whose economic fortunes are tied to shrinking sectors will necessarily take a hit. These losses are not transitory. If I have skills specific to garment production, I will suffer a permanent fall in my earnings even if I manage to avoid unemployment and find a job doing something else. Such income losses are estimated to lie between 8 and 25 percent of pre-displacement earnings in the United States.<sup>11</sup> Any temporary adjustment costs—such as transitional unemployment or a dip in earnings below their long-run level—would be additional to these losses.

Here lies a common misunderstanding in the public debate on trade. Free trade advocates will often grant that some people may get hurt in the short run, but will continue to argue that in the long run everyone (or at least most people) will be better off. In fact there is nothing in economics that guarantees this, and much that suggests otherwise. A famous result due to Wolfgang Stolper and Paul Samuelson states that some groups will *necessarily* suffer long-term losses in income from free trade.<sup>12</sup> In a wealthy country such as the United States, these are likely to be unskilled workers such as high school dropouts.<sup>13</sup> This renders the whole notion of “gains from trade” suspect, since it is not at all clear how we can decide whether a country *as a whole* is better off when some people gain and others lose.

Nor are these ongoing distributional effects specific to the simplified textbook exposition. The trade economist's toolkit encompasses a wide variety of complicated and advanced models of trade, most of which generate sharp distributional conflict from trade.<sup>14</sup> All of these approaches share a fundamental intuition: since economic restructuring generates efficiency gains, and sectors with comparative advantage will expand while others contract, redistribution is often the necessary handmaiden of the gains from trade. Advocates who claim that trade has huge benefits but only modest distributional impacts either do not understand how trade really works, or have to jump through all kinds of hoops to make their arguments halfway coherent. The reality is more simple: no pain, no gain.

The second implication of the classroom exposition is a bit more subtle, and the professor is not likely to dwell on it. But the more attentive among the students will notice that the gains from trade look rather paltry compared to the redistribution of income. It is not just that some win and others lose when tariffs are removed. It is also that the size of the redistribution swamps the “net” gain. This is a generic consequence of trade policy under realistic circumstances.

To drive the point home, I once quantified the ratio of redistribution-to-efficiency gains following the standard assumptions economists make when we present the case for free trade.<sup>15</sup> The numbers I got were huge—so large in fact that I was compelled to redo the calculations several times to make sure I wasn't making a mistake. For example, in an economy like the United States, where average tariffs are below 5 percent, a move to complete free trade would reshuffle more than \$50 of income among different groups for each dollar of efficiency or “net” gain created!<sup>16</sup> Read the last sentence again in case you went through it quickly: we are talking about \$50 of redistribution for every \$1 of aggregate gain. It's as if we give \$51 to Adam, only to leave David \$50 poorer.

A major reason the redistribution-to-efficiency-gains ratio is so high is that tariffs are so low to begin with in today's economy. If tariffs had stood at, say, 40 percent, this ratio would have been around 6 instead.<sup>17</sup> But even in this second case, the redistribution from David to Adam is enormous. It is unlikely that we would countenance so much redistribution in other policy domains without at least some assurance that the process conforms with our conceptions of distributive justice.

When confronted with such situations, most of us would want to know more. Who exactly are David and Adam and what did they do to bring this change about? Is David poorer or richer than Adam, and by how much? How will the proposed move affect them and their families? Does David have access to safety nets and other governmental transfer programs that provide compensation? Some cases will be easy in light of the answers to those questions. If David turns out to be rich, lazy, or otherwise undeserving, and fully responsible for the lousy decisions that result in the loss, we are likely to look kindly on the change. But what if none of these things is true, and Adam has acted in ways that many would consider unethical?

We must ask the same questions when we consider the case of large distributional changes caused by trade. Two questions are of particular importance. Are the gains too small relative to the potential losses to low-income or other disadvantaged groups that may have little recourse to safety nets? And does the trade involve actions that would violate widely shared norms or the social contract if carried out at home—such as employing child labor, repressing labor rights, or using environmentally harmful practices? When the answers to both these questions are yes, the legitimacy of trade will be in question, and appropriately so. There will need to be public debate about the right course of action, which will sometimes result in more rather than less intervention in trade.

These considerations about how we evaluate social changes

with significant distributional effects give us additional insight into why the technical progress analogy fails to provide an airtight argument in favor of free trade. We often assume in the case of new technology that it is generated by innovators and firms that play under a common set of rules. If firm X beats firm Y to a new product or process, it is because X has spent more on R&D, has employed a better business strategy, or has just been lucky—not because Y has been burdened by a different and more costly set of rules. This presumption contributes to our bias in favor of technical progress because it reduces, if not eliminates altogether, the concern that the playing field was tilted against the loser.

Free trade is different. Firms abroad can obtain a competitive advantage not only because they are more productive or labor is more abundant (and hence cheaper), but also because they prevent their workers from engaging in collective bargaining, they have to comply with lower health and safety standards, or they are subsidized by their governments. This is another important way in which differences in institutional arrangements across nations generate opposition and create frictions in international trade.

A second difference is that the adverse effects of new technologies hit different groups over time, so that one can plausibly argue that most, if not all people are made better off over the long run. The candlemaker gets displaced by electric bulbs and the carriage-maker by the auto industry. But each gains from the other innovation. Add these and all other innovations together, let them accumulate over time, and the chance is that everyone comes out better off. Trade, by contrast, often affects the same people time and again. If you are of low skill, have little education, and are not very mobile, international trade has been bad news for you pretty much throughout your entire life. It is much harder in this instance to argue that things will even out in the end.

Finally, low levels of trade barriers bring another issue into play. Even when technological change generates redistribution, it isn't self-limiting. Technology has been the fountain of human eco-

nomic progress since the Industrial Revolution, and there is no reason to suspect that it won't be in the future. By contrast, the gains from removing restrictions on trade run into diminishing returns as trade becomes freer and freer, with the consequence that the distributional effects begin to loom larger and larger. Most recent estimates put the "overall" gains to the United States from a global move to free trade in tenths of 1 percent of U.S. gross domestic product.<sup>18</sup> No doubt certain export interests would benefit considerably more; but the losses to others would be commensurately large as well. The more open an economy is, the worse the redistribution-to-efficiency ratio gets. The political and social-cost-benefit ratio of trade liberalization looks very different when tariffs are 5 percent instead of 50 percent. It is inherent in the economics of trade that going the last few steps to free trade will be particularly difficult because it generates lots of dislocation but little overall gain. There is nothing similarly self-exhausting in the case of technical progress.

So the economist's triangles and technical progress analogy are conversation starters, not conversation enders. Considerations of justice and procedural fairness may complicate the simple (simpliciter) case for gains from trade, but they help us understand why trade is often so contentious. Resistance to free trade is not just a matter of narrow self-interest or ignorance—at least not always.

Importantly, this broader perspective also helps us distinguish pure protectionism from legitimate and well-grounded opposition to free trade. A deserving argument against free trade must overcome at least one of the two hurdles mentioned above: the economic gains from freer trade must remain small compared to the distributional "costs"; and trade must entail practices that violate prevailing norms and social contracts at home. Redistributive provisions that provide large net gains and do not infringe on accepted ways of doing business may be okay; redistributions that fail these tests are open to greater scrutiny. Remember these principles, as

we will use them as building blocks for the reform of the global economic system.

### What Economists Will Not Tell You

Here is an interesting experiment I wish a news reporter would undertake. Let him call an economist on the phone, identifying himself as a reporter, and ask the economist whether she thinks free trade with country X or Y is a good idea. We can be fairly certain about the kind of response he will get: "Oh yes, free trade is a great idea," the economist will immediately say, possibly adding: "And those who are opposed to it either do not understand the principle of comparative advantage, or they represent the selfish interests of certain lobbies (such as labor unions)."

Now let the reporter dress in the casual and rumpled clothes of the typical graduate student in economics and walk into an advanced seminar on international trade theory in any one of the leading universities of the nation. Let him pose the same question to the instructor: Is free trade good? I doubt that the question will be answered as quickly and succinctly this time around. The professor is in fact likely to be stymied and confused by the question. "What do you mean by 'good'?" she may ask. "Good for whom?"

If the reporter/student looks puzzled, she will add: "As we will see later in this course, in most of our models free trade makes some groups better off and others worse off." If this gets disappointed looks, she will then expand: "But under certain conditions, and assuming we can tax the beneficiaries and compensate the losers, freer trade has the *potential* to increase everyone's well-being."

Now the economist has begun to warm up to the subject. She will continue: "Notice how I said, 'under some conditions.' Asking you to list those conditions would make a good exam question, so pay attention as I run through them." Unless your lifelong dream was to become a PhD economist, it is unlikely that you will derive

any pleasure from what is about to come (or any illumination, for that matter). But I must provide a full account of the economics professor's answer, so I will put it all into really small font. Here is what her list of preconditions will look like:

The import liberalization must be complete, covering all goods and trade partners, or else the reduction in import restrictions must take into account the potentially quite complicated structure of substitutability and complementarity across restricted commodities. (So in fact a preferential trade agreement with one or a few trade partners is unlikely to satisfy the requirement.) There must be no microeconomic market imperfections other than the trade restrictions in question, or if there are some, the second-best interactions that are entailed must not be too adverse. The home economy must be "small" in world markets, or else the liberalization must not put the economy on the wrong side of the "optimum tariff." The economy must be in reasonably full employment, or if not, the monetary and fiscal authorities must have effective tools of demand management at their disposal. The income redistributive effects of the liberalization should not be judged undesirable by society at large, or if they are, there must be compensatory tax-transfer schemes with low enough excess burden. There must be no adverse effects on the fiscal balance, or if there are, there must be alternate and expedient ways of making up for the lost fiscal revenues. The liberalization must be politically sustainable and hence credible so that economic agents do not fear or anticipate a reversal.

By now the professor is looking really smug, because she has just shown her students not only how complicated even seemingly simple economics questions are, but also how economic science can shed light (if that is what this jargon can be called!) on the answers.

The journalist/graduate student will not have understood much of this, but at least he has gotten an answer. "So, provided these conditions are satisfied, we can be sure that freer trade will improve our economy's performance and raise its rate of growth?" he may ask hopefully. "Oh, no!" the professor will reply. "Who said anything about growth? These were only the requirements for an increase in the *level* of aggregate real income. Saying something definite about growth is much, much harder." With a self-

satisfied smile on her face, she may then provide the following explanation:

In our standard models with exogenous technological change and diminishing returns to reproducible factors of production (e.g., the neoclassical model of growth), a trade restriction has no effect on the long-run (steady-state) rate of growth of output. This is true regardless of the existence of market imperfections. However, there may be growth effects during the transition to the steady state. (These transitional effects could be positive or negative depending on how the long-run level of output is affected by the trade restriction.) In models of endogenous growth generated by non-diminishing returns to reproducible factors of production or by learning-by-doing and other forms of endogenous technological change, the presumption is that lower trade restrictions boost output growth in the world economy as a whole. But a subset of countries may experience diminished growth depending on their initial factor endowments and levels of technological development. It all depends on whether the forces of comparative advantage pull resources into growth-generating sectors and activities, or away from them.

Noticing the student's expression, the professor may helpfully add, "I think you really have to come to me during office hours for all this."

You don't have to read the fine print above, but if you have deduced that the answer in the seminar room differs greatly from the answer on the phone, you are quite correct. A direct, unqualified assertion about the unquestionable benefits of trade has now been transformed into a statement adorned by all kinds of ifs and buts. Yet somehow the knowledge that the professor willingly imparts with great pride to her advanced students is deemed to be too dangerous for the general public. The qualifications of the seminar room are forgotten lest they lead the public "astray."

This disconnect has always bothered me. In my own research career, I have never—well, almost never—felt censored or pressured to stand for the party line. Academic economists are rewarded for divergent thinking and being innovative. That includes identifying different ways in which markets fail and crafting new argu-

ments for how government intervention in the economy can make things better.<sup>19</sup> Yet unless you are a PhD economist yourself, you are unlikely to have experienced anything of this richness and diversity. In public, economists can always be counted upon to utter the same tired words of praise on behalf of free trade.

Confronted by the gap between what they teach and what they preach, economists will take refuge in a number of arm-waving arguments. Here is a fairly complete list of what you might hear:

1. In practice free trade will make most people better off in the long run, just as technological progress does.
2. Even if trade creates complications, the best way to deal with those is through other policies and not trade restrictions.
3. Even if some people lose out, it should be possible to compensate them and still have everyone come out ahead.
4. The case for free trade goes beyond economics: it is a moral one that has to do with people's freedom to choose who they do business with.
5. Anti-trade views are prevalent enough; our job is to present the other side.
6. The caveats will be hijacked by protectionists who will use them for their own purposes.
7. And besides, the nuances will simply confuse people.

Yet none of these arguments is thought through with anything approaching the level of rigor that goes into demonstrating the standard theorems of trade. None is particularly convincing.

Robert Driskill, a Vanderbilt University economist, has taken the economics profession to task over these failings in a fascinating piece titled "Deconstructing the Argument for Free Trade." He provides a litany of examples from leading textbooks and popular essays in which economists glibly conclude that free trade is "good for the nation" without fully addressing the ethical and philosophical difficulties in making such a statement. As he remarks wryly,

these writings suggest that economists somehow "have solved the problematic nature of knowing what is good for society even when some members of that society are hurt."<sup>20</sup> "[T]he profession has stopped thinking critically about the question," he writes, "and, as a consequence, makes poor-quality arguments justifying their consensus." Most writing by economists on the gains from trade is not a "balanced weighting of the evidence or a critical evaluation of the pros and cons." It is instead akin to "a zealous prosecutor's advocacy." It aims to persuade rather than provide the information with which the reader can form an educated judgment.<sup>21</sup> As Driskill argues, economists should be in the business of presenting the trade-offs rather than passing off their value judgments as the conclusion of scientific research.

Why do economists' analytical minds turn into mush when they talk about trade policy in the real world? Some of it has to do with the idea of comparative advantage being the crown jewel of the profession. It is too painful to let go of. Some boils down to what I call the "barbarians at the gate" syndrome. Economists worry that any doubts they express in public on the benefits of free trade will serve to empower those "barbarians" who are interested not in nuanced views but in pushing for their *dirigiste* agendas. No doubt some has to do with ideology. Even if many economists don't think of themselves as politically conservative, their views tend to be aligned with free market enthusiasts rather than interventionists.

The unanimity that economists exhibit over free trade does not apply to other areas of economic policy. Economists speak with many voices when it comes to important areas of domestic policy such as health, education, or taxes. But on globalization one would have had to look really hard until recently to locate a scholar in any of the top universities who would depart from the boilerplate response. When Driskill submitted his paper for publication to professional journals, he was met by a string of rejections. The editors felt Driskill's arguments didn't add much of significance to the economics literature or to research. They were right, of

course. His points (and mine) about the ambiguities of the case for trade are well known within the professional economics community. The problem is that economists guard them like state secrets and look on those who would share them with ordinary folk as apostates.

When economists oversell globalization by presenting an incomplete case for it, they not only lose an opportunity to educate the public, they also lose credibility. They become viewed as advocates or as hired guns for the “stateless elites” whose only interest is to remove impediments to their international operations. This wouldn’t be all that bad if economics didn’t have a lot to offer. Applied with a good dose of common sense, economics would have prepared us for the flaws we have experienced in globalization. And used appropriately, economic analysis can point us in the right direction for the fixes. Designing a better balance between states and markets—a better globalization—does not mean that we jettison conventional economics. It requires that we actually pay more attention to it. The economics we need is of the “seminar room” variety, not the “rule-of-thumb” kind. It is an economics that recognizes its limitations and caveats and knows that the right message depends on the context. The fine print is what economists have to contribute. I hope the reader will agree that such an economics is possible and think better of economics (even if not of economists) by the end of this book.

	<b>RCEP</b>	<b>TPP</b>
<i>Membership</i>	<p>16 countries in Asia=</p> <ul style="list-style-type: none"> <li>10 ASEAN members: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam</li> <li>6 ASEAN Foreign Partners: Australia, China, India, Japan, New Zealand and South Korea</li> </ul>	<p>12 countries across the Pacific=</p> <ul style="list-style-type: none"> <li>7 Asian members (also in RCEP): Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam</li> <li>Plus Canada, Mexico, Chile, Peru and the United States</li> </ul>
<i>Status of Negotiations</i>	<p><i>Ongoing</i></p> <ul style="list-style-type: none"> <li>16<sup>th</sup> round next week in Jakarta</li> <li>The Asian Trade Centre will be on the ground and will report more next week</li> </ul>	<p><i>Concluded</i></p> <ul style="list-style-type: none"> <li>Agreement signed Feb 2016</li> <li>Japan, New Zealand and others are moving the deal through legislatures</li> <li>US President-elect Donald Trump has promised to withdraw the US in January 2017</li> </ul>
<i>Scope</i>	<p><i>About dozen chapters</i></p> <p>Goods, services, investment, e-commerce, intellectual property, development, legal, and some standards</p>	<p><i>Contains 30 chapters</i></p> <p>Goods, services, investment, e-commerce, trade remedies, intellectual property, government procurement, regulatory coherence, competition policy, environment, labor, legal, standards etc.</p> <p>All texts and schedules are available for viewing at: <a href="http://www.tpp.mfat.govt.nz/text">http://www.tpp.mfat.govt.nz/text</a></p>
<i>Depth of Coverage, Goods</i>	<p><i>Modest?</i></p> <ul style="list-style-type: none"> <li>Deal not yet concluded, but early signs not promising</li> <li>Example: tariff coverage could be at 80%, (20% excluded) and not all drop to 0 even at end of full implementation</li> </ul>	<p><i>Very deep</i></p> <ul style="list-style-type: none"> <li>All goods included, and every tariff line addressed</li> <li>Most tariffs drop to 0, including sensitive items normally carved out or excluded from trade deals, but some problematic tools remain for some (TRQs, safeguards, etc)</li> </ul>
<i>Depth of Coverage, Services</i>	<p><i>Modest?</i></p> <p>Services coverage, so far, not great—limited list of included services sectors, all others not open (positive list scheduling)</p>	<p><i>Excellent</i></p> <p>Every single service sector (160+) opened for TPP member firms except those explicitly listed as closed and most exceptions not commercially meaningful</p>
<i>Depth of Coverage, Investment</i>	<p><i>Strong</i></p> <ul style="list-style-type: none"> <li>Investment, more promising as RCEP members want inbound investment (negative list scheduling)</li> <li>RCEP currently includes ISDS provision to help protect investors</li> </ul>	<p><i>Excellent</i></p> <ul style="list-style-type: none"> <li>Every investment sector also opened for TPP member firms (except for those listed as closed)</li> <li>Strong protection for all investors, including ISDS (although tobacco explicitly carved out of ISDS coverage)</li> </ul>

<i>e-Commerce</i>	<p><i>Should be good</i></p> <p>RCEP should benefit from being negotiated second—e-commerce rules can be broad and include provisions across chapters to benefit smaller firms</p>	<p><i>Good</i></p> <p>First major agreement to cover digital trade and e-commerce. New rules for data flows, encryption, source code. But also has policy flexibilities</p>
<i>Government procurement</i>	<p><i>None (yet)</i></p> <p>(“Expert meetings” have taken place on the topic)</p>	<p><i>Opened to TPP firms</i></p> <p>Government procurement contracts opened for TPP firms at the federal level above a threshold</p>
<i>Competition</i>	<p><i>Yes, unclear?</i></p> <p>Required by leaders’ statement, but unclear where negotiations currently stand because RCEP countries have varying commitments on competition policy at domestic level</p>	<p><i>Strong</i></p> <p>Two chapters on competition, including one to set rules for many state-owned enterprises</p>
<i>Trade Facilitation and Customs</i>	<p><i>Yes, but unclear?</i></p> <p>ASEAN centrality in RCEP means likely following ASEAN rules—with a key role for single windows for customs harmonization?</p>	<p><i>New customs rules</i></p> <p>TPP includes many new provisions including self-certification, advanced rulings, time deadlines for some customs clearance, etc. to move cargo through customs faster and easier</p>
<i>Standards</i>	<p><i>Limited</i></p> <ul style="list-style-type: none"> <li>• Likely to be restatement of existing provisions in WTO and ASEAN+1 agreements?</li> <li>• Perhaps few new rules for food (SPS) and other standards (Note that ASEAN uses different terminology for TBT)</li> </ul>	<p><i>Some New Provisions</i></p> <p>TPP’s SPS and TBT chapters have some provisions that go beyond existing commitments</p>
<i>Intellectual Property</i>	<p><i>New rules</i></p> <p>RCEP countries are moving to include new provisions on IP that go beyond existing commitments, unclear exactly how far and in which areas these will extend, but new rules possible for digital trade?</p>	<p><i>New rules</i></p> <p>TPP created new IP provisions in nearly every category of IP to update existing rulebooks</p>
<i>Trade Remedies</i>	<p><i>Still under discussion</i></p> <p>RCEP continues to have informal discussions, but not yet negotiations on topic</p>	<p><i>Yes</i></p> <p>Short chapter in TPP, although some safeguards, for instance, appear in market access commitments</p>
<i>Movement of People</i>	<p><i>Unclear</i></p> <p>While some have been pushing hard for the movement of services workers, this is highly sensitive for RCEP</p>	<p><i>Minimal</i></p> <p>TPP has a chapter on business mobility that allows the temporary movement of workers for services (mostly for intercorporate transferees)</p>

<i>Environment</i>	<i>None</i>	<i>Yes</i> TPP environment chapter contains commitments on fish, fish subsidies, endangered species trade, logging, ozone, and more
<i>Labor</i>	<i>None</i>	<i>Yes</i> TPP has a chapter on labor which includes protection of worker rights such as no use of forced labor, child labor, minimum wages and decent working conditions
<i>SMEs</i>	<i>Possible chapter?</i>	<i>Chapter, but limited</i> SME chapter in TPP is basically website, but note that commitments in agreement can be very helpful to smaller firms (even if the overall agreement is complicated to use)
<i>Development</i>	<i>Extensive commitments</i> RCEP explicitly recognizes developmental dimensions of trade and builds in flexibilities for developing countries, LDCs, plus capacity programs	<i>Limited commitments</i> TPP includes a norm that all members agree to same provisions with no distinction between countries—hence limited flexibilities and modest capacity building included in agreement
<i>Transparency Provisions</i>	<i>Minimal or modest</i>	<i>Extensive</i> Every chapter in TPP includes provisions for greater transparency, particularly in rulemaking to allow input and time for adjustment
<i>Flexibilities</i>	<i>Extensive</i> Nearly every provision includes extensive flexibilities for members	<i>Limited</i> Flexibilities granted for public health, animal health, public security, etc. Otherwise, limited flexibilities in agreement
<i>Dispute Settlement</i>	<i>Yes, unlikely to be used?</i> The track record in Asian agreements suggests that dispute settlement provisions will not be used in RCEP—disputes likely to be taken up at WTO?	<i>Designed to be used regularly</i> TPP provisions on disputes show intentions to use provisions (although potential absence of Americans from final agreement may alter use of DSM?)
<i>Third Party Participation in the Negotiating Process</i>	<i>Almost none</i> RCEP has provided limited options for third-parties (businesses, NGOs, media) to provide input at domestic level or directly to officials or to learn about outcomes	<i>Extensive</i> Some TPP members provided extensive opportunities for input at the domestic level plus the TPP included stakeholder outreach sessions for input directly to officials and had media follow negotiation rounds

<i>Accession clause</i>	<i>Unclear</i> Officially, the criteria for membership in RCEP is an existing ASEAN agreement	<i>Yes</i> Explicit provisions for adding new members—gives priority to APEC members, but not limited to APEC only
<i>What next?</i>	<i>Negotiations continue</i> RCEP has 4 rounds currently scheduled for 2017—hope is to conclude by end of year?	<i>Domestic ratification? Death?</i> Unclear what happens next—will TPP move forward without the US? Will agreement wait for all 12 parties? Will it just die?