

# RULEMAKING IN SUPER-RTAS: IMPLICATIONS FOR CHINA AND INDIA

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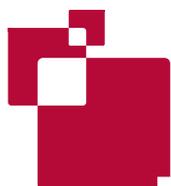
## Highlights

- The faltering Doha Round has led to a renewed focus on large regional trade agreements. There are two super-RTAs in the making in the Asia-Pacific and one in the Atlantic, all with rather ambitious negotiation targets, and presented as alternate means to reset global trade rules and take the multilateral trade liberalisation agenda forward.
- So what does this development mean for large emerging markets such as China and India that are on the fringes of these regional trade negotiations? Can these agreements become alternate means of pressuring these Asian economies to follow new trade rules set by industrialised countries, especially given the progressive erosion of the policy dominance of industrialised countries and the strong dissenting voice of developing countries in the Doha Round?
- This paper examines how super-RTAs may emerge as game changers in the multilateral trading system as promulgated by the WTO, and the implications for China and India. The paper analyses the new economic governance system that is likely to emerge given the renewed interest in regionalism, and argues that while the super-RTAs will not be entirely benign in their impact on China and India, rather than forcing these economies to accept the higher new regulatory standards enshrined in the super-RTAs, a distinct possibility in the medium-term is the emergence and entrenchment of a dual regulatory regime in these economies.

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## 1. Introduction

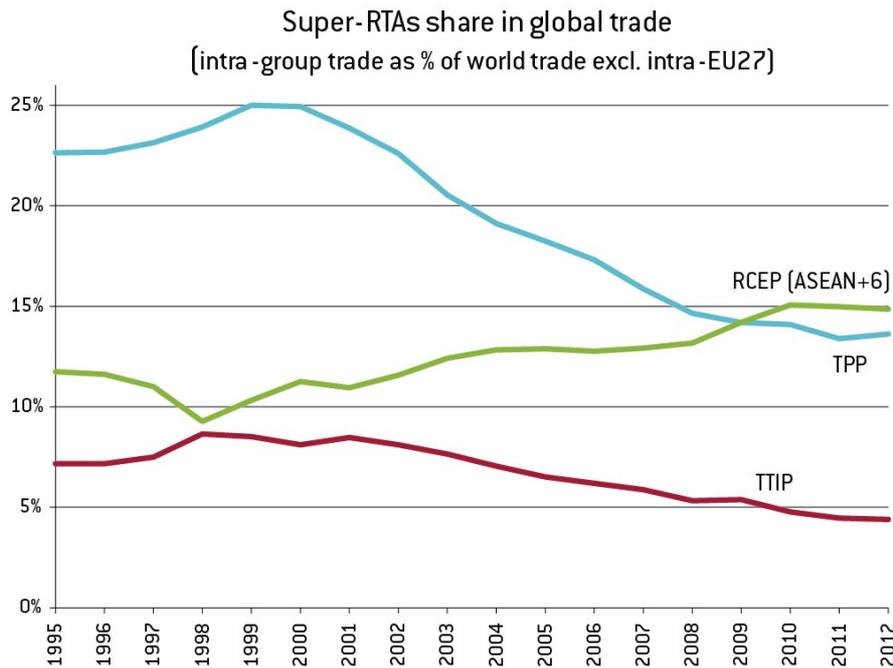
When seen through the trade policy lens, an otherwise unremarkable 2013 may well be remembered for entrenching a new chapter in the nature of multilateral trade negotiations. After a long period of post-NAFTA (North American Free Trade Agreement) World Trade Organisation (WTO)-centric trade liberalisation, there is now a new zeal for negotiating multi-nation regional initiatives (mega-regionals) or super-regional trade agreements (henceforth super-RTAs)<sup>1</sup>. Given their design and structuring, these negotiations are not held on a global multilateral basis, although they are being negotiated between rather large and diverse groups of economic entities that together account for over 60 percent of global trade. This latter feature makes them somewhat multilateral and “*brings to mind the early GATT Rounds*” (Dadush, 2013). In the making there are two super-RTAs in the Asia-Pacific region, namely the negotiations on Regional Comprehensive Economic Partnership agreement (RCEP or the ASEAN+6) and the US-led Trans-Pacific Partnership (TPP), and one transatlantic super-RTA: the Transatlantic Trade and Investment Partnership (TTIP) between the US and the 28-member European Union. These talks are intended to achieve 'gold standard' deep and comprehensive trade agreements, setting new rules and regulatory standards that are expected to put pressure on the large emerging economies left outside the deals to adapt or suffer the consequences<sup>2</sup>.

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<sup>1</sup> In the earlier phase, EU, ASEAN, NAFTA, APEC and Mercosur were all part of a larger politico-strategic commitment to regionalism that used trade policy to ensure that the overall competitive strengths of the target regions were maximised.

<sup>2</sup> Bergsten (1996) showed that fear of being crowded out of export markets as a result of trade agreements between partners – ie trade diversion effects – was a powerful motivation to engage in new multilateral negotiations. In the early 1990s in particular, NAFTA helped to bring closure to the WTO's Uruguay Round negotiations.

**Figure 1: Trade within the super-RTA groups relative to extra-EU global trade**



Source: Bruegel based on UNCTAD data.

The popular explanation for this renewed interest in regionalism lies in the moribund nature of the Doha Round of multilateral free-trade talks and the fear of outright exclusion or reduced influence of the industrialised countries in a new world in which emerging economies have an increasingly stronger voice in global rule/policy making. The new super-RTAs have therefore *de facto* taken over the responsibility for establishing global trade rules that address current and prospective trade concerns, which the 12 year-old somnambulant Doha Round is deemed unable to address. The super-RTAs are also designed to counteract the increasing loss of influence of industrialised countries in world trade matters (Figure 1 shows a dramatic fall in the TPP and TTIP groups' share of extra-EU world trade since 2000). In this respect, the situation is starkly different from the early years of GATT, when the industrialised countries were able to influence the structuring of global trade rules in their favour, which still continues through historic legacy. This is also implicit in the demand of the key emerging economy WTO members at the Doha Round negotiations to level the existing uneven playing field, a move that can potentially be subverted by the creation of new multilateral trading forums such as the TPP and the TTIP. Interestingly, “(o)f the 26 Geneva Round participantsE twelve are participating in the TTIP, three are participating in the TPP, and one—the United States, positioned once again at the center of the system—is participating in both” (Dadush, 2013).

But what does this development mean for the large Asian emerging economies such as China and India, which are on the fringes of these super-RTA negotiations? Will the regionals be alternate ways to

pressure the large emerging economies to follow new trade rules and tougher regulations set by the industrialised countries, especially given the strong (dissenting) voice of economies such as China and India in the ongoing WTO negotiations on many of the proposals from western countries? An important case in point is the proposal for ever-stronger intellectual property protection in the US-led trade agreements. This can *de facto* undermine some of the safeguards (albeit rarely used) that the TRIPS agreement provides to developing countries by allowing a certain degree of flexibility to limit patent protection in the interest of the health concerns of their citizens. The TPP in particular is deemed retrogressive in several of its elements, given its US-corporate-sector-led agenda, and it might in these respects even work against WTO principles<sup>3</sup>.

It should be remembered that navigating such large regional agreements is not a new experience, and developing countries live with the asymmetries enshrined in NAFTA and APEC in the last century. That said, the twenty-first century is a whole new world, and this paper will assess how super-RTAs might emerge as game changers in the multilateral trade rules promulgated by the WTO.

To do this, we briefly outline the scope and ambition level of the super-RTA negotiations, and then examine how their new asymmetric provisions might impact China and India. We discuss the possibility of the dispute settlement mechanisms (DSMs) designed in these agreements becoming multilateralised and posing serious challenges to the WTO's role as global rule-maker and arbiter. *Prima facie*, the new super-RTAs run the risk of exacerbating the divergence between regional and WTO trade rules by continuing to erode the WTO's central position in multilateral trade dispute settlement, and might emerge as game changers in the global trade governance. We will address this through an analysis of the feasibility of regulatory cohesion under the super-RTAs given the existing institutional mechanisms, trade policy and regulatory philosophy (and practice) in selected stakeholder countries, as a reality check on the proposed subversion of the global trade governance regime.

The paper is structured as follows. Section 2 discusses in brief the scope and state of play in the different super-RTAs. Section 3 examines the possible impact of super-RTAs on China and India, addressing the problem from the perspective of political-economy effects of regulatory (regime) change. Section 4 concludes with some policy and strategy options for these two emerging Asian countries, taking into account the recent dynamic developments in their economic and trade policy strategies.

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<sup>3</sup> For example, in the case of its treatment of the sensitive issue of data exclusivity and ever-greening of drug patents. Prompted by the domestic pharmaceutical lobby, in the TPP, the USTR's office is reportedly backtracking on WTO principles – for example, access to generic medicines – that Congress had inserted into its earlier trade agreements, like that with Peru. This over-riding of WTO principles may have particularly serious implications for emerging Asian countries with multiple public policy objectives. Panagariya (2014) offers an analysis of the ongoing US-India discontent on the latter's TRIPS obligations.

## 2. Scope and ambition in super-RTA negotiations

All three of the super-RTAs are being negotiated in the single undertaking mode under which nothing is agreed to until everything is agreed.

RCEP, driven by ASEAN, is a free-trade agreement between ASEAN and its regional partners – Australia, New Zealand, China, South Korea, Japan and India. It is envisaged as a mutually beneficial economic partnership agreement that will broaden and deepen current free-trade engagements in the region. RCEP is designed to be WTO-compliant and is based on an open accession clause, ie welcoming the participation of any ASEAN partner that chooses to participate later (dubbed 'open-regionalism'). It is also the only super-RTA that involves the two emerging Asian giants, namely China and India. According to a recent study by Petri, Plummer and Zhai (2012)<sup>4</sup>, the deal will provide income gains of around US\$644 billion in 2025, representing 0.6 percent of the world's GDP, through the freer flow of goods, services, investments and labour between the participating economies<sup>5</sup>. However, concluding a high-level deep agreement is not going to be an easy task, especially as the RCEP's guiding principles are to recognise *"the individual and diverse circumstances"*, take into consideration *"the different levels of development of the participating countries"* and allow for *"appropriate forms of flexibility including provision for special and differential treatment, plus additional flexibility to the least-developed ASEAN Member States"* (ASEAN, 2012).

The TPP, now with 12 participating countries led by the US<sup>6</sup> (Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam), is meanwhile being pushed as a 'living agreement' with a 'WTO-plus' approach<sup>7</sup>. The countries involved accelerated their work to meet the target of concluding a deal by the end of 2013, but breakthroughs are yet to be reached in the discussions and officials (and industry experts) agree that landing zones are not in sight in many of the contentious issues, viz. intellectual property, state-owned enterprises, financial regulation. Petri, Plummer and Zhai (2012) estimate that an ambitious TPP could yield annual global income gains of US\$295 billion in 2025, with more benefits accruing to the countries that joined later,

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<sup>4</sup> For summaries on net global and country-specific gains see, *Note on Alternative Asian Track Scenarios* at <http://asiapacifictrade.org/wp-content/uploads/2012/11/Asian-track-alternatives.pdf>.

<sup>5</sup> Fukunaga and Isono (2013) argue that realising the RCEP potential will call for a comprehensive and high-level agreement by 2015, that (1) sets the target of 95 percent tariff elimination with a "common concession" approach, (2) introduces the "core non-tariff measures (NTMs)" concept and removes them, allows co-equal rules in the rules of origin (ROOs), setting a general rule of "RVC(40) or CTH" (i.e. "40 percent regional value added or change in tariff heading at 4-digit levels") and developing consolidated operational certification procedures; (3) introduces concrete and tangible trade facilitation programmes and addressing FTA utilisation issues; and (4) liberalises trade in services at a high level.

<sup>6</sup> The 4-member Trans-Pacific Strategic Economic Partnership Agreement (TPSEP or P4) of 2005, a free trade agreement between Brunei, Chile, Singapore, and New Zealand, was expanded in March 2010 to include other interested parties from the Asia-Pacific Economic Cooperation (APEC), most importantly the US.

suggesting that enlargement of the agreement is “*incentive consistent*”<sup>8</sup>. The trade liberalisation rate, a key indicator of a nation’s willingness to open up its markets, differs from one trade partner to another, but the standard rate among TPP members is more than 90 percent. However, the TPP rules call for the negotiating process to be managed by a small group of people, and for circulation of information beyond this group to be limited, and this lack of transparency is a major source of concern<sup>9</sup> for all non-member countries, and even for key stakeholders in the TPP member countries including in the US, especially those that fear potential losses because of the agreement. Bridging the differences between the members at various stages of economic development to arrive at a high-level agreement is expected to be another difficult task, especially when it comes to sensitive sectors<sup>10</sup>. Finally, the lack of a ‘fast-track’ process for congressional approval in the US is now acknowledged to be a deterrent for the conclusion of the TPP; without the Presidential fast-track authority (widely not expected to be granted until after the US mid-term elections in November), TPP partners are unlikely to make their final offers for fear of the deal being unravelled by the US Congress.

The RCEP builds on ASEAN’s experience and is expected to bring together all the five ASEAN+1 free-trade agreements (FTAs) into an integrated regional economic framework. The RCEP’s ASEAN-centricity implies that it will be guided by the ‘ASEAN way,’ under which objectives and commitments are driven by a consensus decision-making process and are voluntary and non-binding. By comparison, in addition to the trade component in goods, services and investment, the TPP is expected to have a more demanding set of market access commitments in ‘WTO-plus’ issues and in the ‘WTO-extra’ subjects (categorisation by Horn *et al*, 2009) that are beyond the WTO’s current mandate: intellectual property (IP) rights, labour standards, competition policy, investment rules, customs laws, e-commerce, the environment, government procurement and the role of state-owned enterprises. Most of these issues might not have immediate direct trade-related aspects but are deemed to be twenty-first century challenges (Basu Das, 2013). The TPP is being promoted as a ‘gold-standard’ free-trade agreement and is expected to harmonise conditions for businesses in the Asia-Pacific region through regulatory convergence among members, going beyond the recent trade facilitation agreement negotiated at the WTO’s Bali ministerial conference (Karmakar, 2013a, evaluates the net gains from the WTO Bali deal).

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<sup>7</sup> The term ‘WTO-plus’ is applied in various contexts. It basically reflects the commitments made or obligations assumed that are more stringent than what is currently imposed or required under the WTO agreements.

<sup>8</sup> For summaries on net global and country-specific gains see, *Note on Alternative TPP-Track Scenarios* at <http://asiapacifictrade.org/wp-content/uploads/2012/11/TPP-track-alternatives.pdf>

<sup>9</sup> TPP is also criticised for its retrogressive elements like non-transparent negotiations and a divisive approach to integration.

<sup>10</sup> The TPP has stirred protests in various countries amid fears it could leave domestic markets exposed to foreign competition. Powerful agriculture lobbies in Japan are resisting the TPP and concerns have been raised that Japanese demands for exceptions in its five sensitive farm products may present a sticking point. Several countries have also indicated “serious difficulties” with the agreement’s potential impact on state-owned firms.

However, TPP members are at different levels of economic development and the WTO-plus issues covered under the TPP will require significant reform to the domestic industrial and economic policies of most members, and might raise challenges for the countries/sectors that need economic reform and for economies that have state-owned enterprises.

### **Box 1: State of play in the three super-RTA negotiations**

RCEP is a 16-member group driven by ASEAN which launched negotiations in November 2012. The third round of negotiations was held 20-24 January 2014. Negotiations are expected to be concluded by end-2015. It proposes to create a 16-country integrated market in the Asia-Pacific region of around 3.35 billion people with a combined GDP of US\$21.4 trillion or 27 percent of global GDP.

TPP is a US-led initiative now with 12 participating countries; the group held its twenty-first meeting in Singapore 7-10 December 2013. The agreement was originally proposed to be concluded by the end of 2013, but unforeseen delays have led negotiators to push the target completion date to mid-2014. TPP-12 countries, representing more than 800 million people, account for nearly 40 percent of global GDP and about one-third of world trade.

TTIP is the newest super-RTA, with negotiations launched in March 2013 and talks still at a very early stage. Originally proposed for an end-2014 conclusion, slippage is already apparent; officials caution that the informal mid-2014 deadline to conclude TTIP negotiations is now likely to be pushed back to 2015. The range and complexity of the potential regulatory issues are also so vast that EU officials admit they would be unlikely to be finalised in a single deal. Instead, TTIP would function more as a 'living agreement', which would establish a framework for regulators.

The transatlantic TTIP is an ambitious, comprehensive, and high-standard trade and investment agreement that will offer significant benefits by promoting international competitiveness, jobs and growth in the partner countries. Together, the US and the EU account for almost half of global output and a third of world trade<sup>11</sup>; the stock of shared direct investment adds up to more than US\$3.6 trillion. The aim of TTIP is “to liberalise, as much as possible, trade and investment between the two blocs” in the 20 areas<sup>12</sup> that the agreement is expected to cover. An independent study by Francois et al (2013)

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<sup>11</sup> Bilateral trade as a share of global trade (excluding intra-EU trade) however has declined sharply by nearly half since 2001, and according to the latest UNCTAD data was at 4.39 percent in 2012.

<sup>12</sup> These include: market access for agricultural and industrial goods, government procurement, investment, energy and raw materials, regulatory issues, sanitary and phytosanitary measures, services, intellectual property rights, sustainable development, small- and medium-sized enterprises, dispute settlement, competition, customs/trade facilitation, and state-owned enterprises. The comprehensive trade and investment agreement aims to achieve ambitious outcomes in three broad areas: a) market access; b) regulatory issues and non-tariff barriers; and c) rules, principles, and new modes of cooperation to address shared global trade challenges and opportunities.

estimated that an ambitious and comprehensive<sup>13</sup> agreement could bring significant economic gains for the EU as a whole (approximately US\$88.7 to US\$155.1 billion a year until 2027, depending on the content of the negotiated agreement) and for the US (US\$64.4 to US\$123.5 billion a year), while increasing global income by almost US\$130 billion annually as a result of increased bilateral trade.

However, as much as 80 percent of the total potential gains from the TTIP are to come from cutting costs imposed by bureaucracy and regulations (so-called non-tariff barriers or NTBs), and from liberalising trade in services and public procurement. Although tariffs between the US and the EU are already low (on average 4 percent), the cost of dealing with unnecessary bureaucracy can add an equivalent to tariffs of 10-20 percent to the price of goods, which is usually borne by consumers. But tackling these kinds of non-tariff barriers is easier said than done, and the two trade partners have been discussing regulatory harmonisation in key traded products/sectors for nearly two decades now. Also, the remaining tariffs will be harder to reduce than imagined. High tariffs in sugar, textiles and garments, steel and trucks have existed for so long because there are powerful vested interests that are loath to forgo their advantages. Finally, the TTIP negotiations are not all encompassing; they will not cover agricultural subsidies, subsidies to aircraft manufacturers or movement of temporary workers, nor are likely to comprehensively cover IP rules and financial sector regulation. Therefore, and despite different studies having already outlined the economic and strategic benefits of TTIP, the debate is still open on the feasibility of a deep trade agreement, and even its desirability.

It is envisaged that the super-RTAs will generate new momentum for multilateral liberalisation and provide a boost to trade and economic growth in the participating industrialised member countries. The agreements will also reinforce the global influence of participants as international standard- and rule-setters. This directly reflects the unease in the industrialised world about the turbo-charged rise of the emerging economies over the earlier decade, and the fear that the global order is no longer dictated by the West, which, in particular, is less able to stand up to an increasingly economically powerful China (and possibly also India in the near future). To Stiglitz (2013) these negotiations are *“not about establishing a true free-trade system. Instead, the goal is a managed trade regime —managed, that is, to serve the special interests that have long dominated trade policy in the West,”* while to Messerlin (2012), they are a strategy to *“bypass the WTO’s consensus structure and write the rules of ‘WTO version 2.0’.”* However, given that most of the gains are expected to emerge from eliminating regulatory and beyond-the-border barriers (merchandise trade is largely free already), the impact of

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<sup>13</sup> The comprehensive option includes two scenarios: a less ambitious agreement that includes a 10 percent reduction in trade costs from NTBs and nearly full tariff removal (98 percent of tariffs) and an ambitious scenario that includes the elimination of 25 percent of NTB related costs and 100 percent of tariffs. In both scenarios more ambition is imposed on the lowering of procurement-related NTBs than for other NTBs affecting goods and services. It is assumed that NTBs linked to procurement are reduced by 25 percent or 50 percent, in the “less ambitious” and in the “ambitious” scenarios respectively.

which is as difficult to measure and attribute to increased trade flows as it is to eliminate the barriers in the first place, a large part of the projected gains might remain unrealised.

### **3. The impact of super-RTAs on China and India**

We now examine the potential impact of the super-RTA's on two non-member large emerging markets, China and India. The impact can be felt in two ways: (1) indirectly by undermining the WTO's pre-eminence as a multilateral rule-setter and arbiter, and (2) directly because of the 'rearranging of the deck' which these super-RTAs aim to achieve.

In the first *indirect* case, clearly, the overriding concern from the WTO's perspective is the prospect that it will increasingly become irrelevant as a trade liberalisation platform, should the super-RTAs manage to achieve their ambitious liberalisation and regulatory harmonisation targets before the Doha Round is formally concluded, though this remains doubtful because meeting the highly ambitious timelines are already proving to be impossible unless the scope of the agreements is considerably diluted<sup>14</sup>. The conclusion of these deep RTAs will however be disadvantageous to the emerging economies not only because of their exclusion during the treaties' formation phase, but more because the WTO-led multilateral decision-making and adjudication processes give these countries equal voice<sup>15</sup> and ability to address domestic growth concerns and sensitivities. Regionalism as envisaged in the super-RTAs is thus a sub-optimal strategy for China and India, especially at their present stage of development.

Two direct consequences of rapid growth in large developing countries has been that (i) the old Quad (the EU, the US, Japan and Canada) that could once hammer out multilateral trade deals at the GATT/WTO has less relevance today, and (ii) there is a greatly muted reaction from the large developing countries (bordering on ennui) to any regional trade agreement negotiated by the Quad members. Sustained growth in large emerging economies has also eroded the ability of the old Quad to negotiate global trade deals that meet the expectations and interests of their domestic industry stakeholders. Hence the understandable disconnection of industrialised country business lobbyists from the Doha Round<sup>16</sup>, in stark contrast to their very active engagement and the political pressure that they exercised during the Uruguay Round. Also, NAFTA exerted a perceptible domino effect during the

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<sup>14</sup> However, following the missed 2013 goalpost of TPP, negotiators expressed their will to continue intensive work with flexibility to finalise the text issues as well as market access issues towards an ambitious agreement.

<sup>15</sup> Arising from the WTO's egalitarian one-country-one-vote principle and equal veto powers for all members.

<sup>16</sup> One of the big problems of the Doha talks is that they have attracted very little interest from the US business community whose support is absolutely necessary to get US Congressional approval, especially in view of the absence of a Presidential "fast track" authorisation for negotiating trade agreements.

closing days of the Uruguay Round, leading to the capitulation of many a nay-sayer. But, as succinctly put by a leading trade analyst at a recent meeting, the “*days of neo-classical ‘build it and they’ll beg to join’ treaty constructs are long over*”<sup>17</sup>. Hence, both industrialised and developing countries are focused on negotiating regional and bilateral agreements that suit domestic interests. Nevertheless, the current WTO rules served well during the recent economic and financial crisis, with relatively little increase in protectionism, notwithstanding the massive structural changes (compounded by the crisis) associated with the unprecedented rise of emerging markets, in particular China. This experience has underlined that, despite its supposed inability to seal the market access negotiations, the WTO’s dispute-settlement abilities and role as a global arbitrator/rules enforcer remains undiminished and as yet unchallenged.

However, with the so-called ‘proliferation’ of more solid and far-reaching dispute settlement mechanisms in the RTAs, there is a fear of overlap and conflicts with the WTO Dispute Settlement Mechanism. This has the potential to become a major factor in the governance of global trade. Studies of the RTA dispute settlement mechanisms usually highlight that the increased density, volume and complexity of international norms requiring correspondingly sophisticated mechanisms to guarantee their smooth operation and accurate interpretation are the key reason why RTA dispute settlement mechanisms are needed. Such dispute settlement mechanisms have also started to challenge the coherence of international jurisprudence. As the jurisdiction of WTO bodies broadens, along with regional courts and tribunals, the possibility of overlap seems to increase (Biukovic, 2008). So far the RTAs have created intergovernmental structures with relatively weak enforcement mechanisms, but this is expected to change with the super-RTAs. The super-RTAs are led by strong rule-oriented economies such as the US and the EU, which have the necessary will and capability to establish stronger institutions and to implement monitoring and enforcement mechanisms, as has been done during European integration and to a lesser extent in NAFTA.

Moreover, the potential for jurisdictional overlap between the WTO and RTA dispute settlement mechanisms stem not only from jurisdictional overlaps leading to a ‘double breach’ of both an RTA obligation and a WTO obligation, but also from the deliberate creation of RTA countermeasures that violate WTO rules<sup>18</sup>. While they retain the ‘regional’ moniker, the fact that super-RTAs now involve

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<sup>17</sup> Pierre Sauve, at the IMD organised meeting entitled “WTO Blueskying: Ideas for the new DG”, 28 June, 2013.

<sup>18</sup> Given that many countermeasures capable of being taken under an RTA will involve a breach of WTO obligations, it becomes necessary to reflect further on the nature of the permission the WTO gives its members to conclude RTAs and whether this permission entails that RTAs parties may use trade countermeasures in their RTA relations. There is no clear provision in the WTO stating whether RTAs parties can take a trade-countermeasure that would be inconsistent with WTO obligations. Ultimately, the answer to this question depends on whether GATT Article XXIV and GATS Article V provide an exception for all measures taken in conformity with a WTO compliant RTA, or instead require some sort of ‘connection’ between the measure claimed to be taken in conformity with the RTA and the WTO. In sum the legal consequences of the

countries spanning the globe makes them multilateral to some degree, and proportionately increases the likelihood that super-RTA dispute settlement mechanisms will exacerbate divergences between regional and WTO trade rules by continuing to erode the central role of the WTO in multilateral trade jurisprudence. A related concern is the potential threat of forum shopping by industrial country multinational corporations in favour of the RTA dispute settlement mechanisms, which will most likely allow for investor-state dispute settlement mechanisms as opposed to the state-state dispute mechanism under the WTO<sup>19</sup>. As more and more economies plug into global value-chain production systems, sovereign governments will have less control over the likely preference of multinationals to opt for investor-state dispute settlement mechanisms. The consequent rise in RTA dispute settlement mechanism jurisprudence will further accelerate the erosion of the WTO's centrality in multilateral trade dispute resolution, as the judgements from the former can be used to argue for future WTO-DSM cases.

With respect to their *direct impact* on China and India, there appear to be two major areas of influence of the super-RTAs. The first is their potential impact on the regional production networks. RTAs such as the RCEP and TPP, are expected to support emerging international production networks, by reducing the administrative and regulatory costs of doing business in member states. Keeping this in mind, the super-RTAs might give more priority to certain service sectors, such as transportation, telecommunications, ICT, logistics and financial services, that contribute to or take advantage of the formation of international production and distribution networks, but some of which might be difficult to replicate in emerging markets. While how that dynamic situation is likely to play out is unclear, it seems likely that China's present central role in the Asia-Pacific production networks and supply chains will be adversely affected<sup>20</sup>. This is all the more so given that the US-led super-RTAs put business-friendly regulatory coherence in WTO-plus and WTO-extra issues at the heart of their key deliverables, and China's domestic regulations on IP and government procurement, for example, hardly come close to those likely to be adopted.

However a deeper analysis of the potential impact of the super-RTAs on China (assuming a marginal net impact of RCEP in terms of countering the TPP effects) reveal that the net effect of a future scenario in which preferential market access in RTAs that do not include China pushes China out of the regional

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overlaps between the operation of any RTA-DSM and that of the WTO are far from clear (Marceau and Wyatt 2010).

<sup>19</sup> The desire of companies to include dispute-settlement provisions that enable them to sue states directly is also causing a stir among some civil society representatives. It raises the issue of whether, for example, oil companies would be able to sue governments over a fracking moratorium. Activists fear that health and environmental concerns could suffer as a result of such investor-state dispute-settlement provisions (Dadush, 2013).

<sup>20</sup> India is not very relevant for this discourse as the country is not a significant part of any major manufacturing or services global supply chain at the moment, largely because of its competitiveness-sapping industrial-labour policies and fractious domestic politics. However, assuming that the situation changes in the near term, this analysis will be equally applicable for India.

production networks and supply chains, might not be as drastic in pure economic terms. This assessment stems from: (i) Because of the already low MFN<sup>21</sup> tariffs in most of its large trade partners, the trade, investment and production diversion effect of the super-RTAs in pure tariff terms is going to be small, and not only because the preference margins of RTA tariffs tend to be low anyway (nearly all available evidence suggests that the trade-preference margins in RTAs are typically less than one percent). (ii) On the other hand, in view of its domestic labour-cost and other economic rebalancing compulsions in the aftermath of the 2008 financial crisis, China has been voluntarily moving away from the low-value-added-end of the export-production spectrum<sup>22</sup> that benefits most from the tariff preferences, which further mutes the impact of a production network restructuring *sans* China as a result of the regional super-RTA. (iii) Lastly, insofar as the potential 10-20 percent tariff-equivalent gains from harmonisation of administrative rules and regulatory standards aimed at supply-chain smoothing within the super-RTA is concerned, getting the members to agree on deep integration is proving to be a rather difficult challenge to overcome in both the TPP and TTIP, in both the reciprocal tariff negotiations<sup>23</sup> and non-tariff regulatory coherence and rule-making processes of these super-RTA negotiations; this then implies that the potential minimum 10 percent tariff-equivalent disadvantage because of non-compliant regulations or regulatory discrimination is not a critical concern for China at the moment.

However, assuming that the super-RTAs do lead to a deep liberalisation and achieve regulatory coherence in the near future, a restructuring and/or fragmentation of global supply chains as a consequence remains a real threat for the large Asian emerging economies, in particular China. These economies might then react in any of the following three ways:

(i) They adopt and upgrade to these new rules, regulations and industrial standards, even at some financial and political cost, in order to reduce the business costs of serving a world market. China took

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<sup>21</sup> In modern international economic relations and international politics, most favoured nation or MFN is a status or level of treatment accorded by one state to another in international trade. The term means the country which is the recipient of this treatment must, nominally, receive equal trade advantages as the "most favoured nation" by the country granting such treatment. In effect, under the WTO agreements, countries cannot normally discriminate between their trading partners. In contrast, in the early days of international trade, MFN status was usually used on a dual-party, state-to-state basis.

<sup>22</sup> The transformation in Chinese supply chains has evolved almost unnoticed over several years. Many Chinese contract manufacturers are now building their own brands, investing in R&D and innovation, and tapping into China's domestic markets rather than just exporting their output. This is supported by the new industrial policy thrust in the latest Five Year Plan of the PRC which aims for a rebalancing from resource-intensive industries to labour-, capital-, and technology-intensive industries by focusing on strategic emerging industries, at least in the short term. Detailed plans from the State Council, the Development and Reform Commission, and the Ministry of Industry talk constantly of "*establishing global supply chains that allow China to control prices*", "*to make industry contribute more to the comprehensive national power*", and "*to reduce dependence on foreign producers*" (State Council, 2013). An analysis of the new service sector policies can be found in Karmakar, 2012.

<sup>23</sup> Reciprocity is sign of resistance to openness, and we know that early GATT opening had been mostly unilateral, which had benefitted the liberalisers more than the so-called free-riders.

this approach when it adopted and pre-committed to stricter WTO disciplines during its accession process, which helped it to become the world's most competitive economy. Indian exporters treat these costs as fixed before making the decision to export to industrialised country markets, often simultaneously meeting both the US- and EU-led standards (which are almost always higher than India's domestic standards) in order to avoid rejection of consignments<sup>24</sup>. Chinese and Indian experience has shown that pragmatically accepting and adapting to new realities bear fruit.

(ii) They selectively refute the rules and production standards, based on domestic interest and the perceived market for their products in the new global economic architecture in which developing countries and their domestic markets account for almost 40 percent of global economic activity at current US\$, and more than 50 percent at US\$, PPP (WTO, 2013); by 2050, it is estimated that six of world's seven largest economies will be outside the OECD group. The new stringent rules regarding IP, state-owned enterprises, services sector regulations, government procurement, environmental regulations and dispute-resolution mechanisms in investment protection agreements are prime candidates for such rebuttal.

(iii) A third, and more likely possibility is that the emerging economies might operate on a *sui generis* dual regulatory regime in the medium term in key areas such as product standards and intellectual property (IP). Taking the example of the TTIP negotiations, even if the EU and US manage to create a "transatlantic (regulatory) fortress" or Economic NATO as a defence against export competition from the rising Asian emerging markets, especially China, it is uncertain that they will be able to entice these large emerging economies into adopting those rules simply out of fear of exclusion. In a recent development, both China and India initially ruled out joining negotiations on a US- and EU-backed proposal to expand the 1996 Information Technology Agreement (ITA), though both have benefited from the original ITA in multiple ways.

The compelling reason for these economies to not unilaterally upgrade to the higher standards and rules, albeit harmonised, arise from the existing and expected demand structure in these economies (Kharas, 2010). A recent World Bank study shows that in 2011 the per capita GDP of Brazil was US\$12,594, South Africa was US\$8,070, China was US\$5,445 and India was US\$1,489, while the average per capita GDP in OECD countries was US\$41,225, with the US per capita GDP being US\$48,112<sup>25</sup>. The demand growth is also expected to be higher in the emerging markets in the next few

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<sup>24</sup> Based on interviews undertaken by the author of Indian SME's in electrical and electronic manufactured products and exporting to both US and EU. Meeting multiple conformity assessment and differing standards add to costs, which the standards harmonisation will help to reduce, boosting competitiveness and even production consolidation.

<sup>25</sup> A recent report by PwC, average real wages in emerging markets like India could more than quadruple over by 2030, thus reducing the gaps with US and UK. However, India's current average monthly wage is around 25 times smaller than that of

decades<sup>26</sup>. In such a situation, given that effective demand from the price-sensitive large emerging middle class<sup>27</sup> is likely to remain high at home and in similar developing country markets that their domestic producers/brands can easily serve, a mass domestic upgrade to the costlier higher regulatory standards, albeit desirable, might not seem optimal to Chinese and Indian policymakers, at least in the near future.

A more likely medium-term outcome is the possibility of operation of a dual regulatory regime, with the export-oriented firms in these economies adopting the higher standards, while a large part of the remaining producers servicing the domestic market continuing to use the old, less rigorous standards and IP regimes<sup>28</sup>. If the latter group is significantly large (although difficult to quantify, this share is likely to remain about two-thirds of the total population in China and India for the next decade according to various estimates), the incentive for emerging economy governments to sign up to more rigorous multilateral regulatory standards will diminish, at least until the majority of domestic consumers can afford to pay the quality premium on the higher-standard discretionary products and services<sup>29</sup>. Even the most optimistic TTIP and TPP analysts do not seem to expect that a truly 'deep' agreement outlining "*gold standard regulatory cooperation*" will be operational in the medium term, as hegemony traditionally have not shown much inclination to compromise. Much therefore will depend

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the UK; by 2030, it is likely to be only 7.5 times smaller. Over the same period, the average monthly Chinese wages could rise to around half of that of Spain. But the wage and purchasing power gap is expected to continue in the medium term, and this coupled with the forecasted exponential growth in the EM middle classes would in turn re-shape the global businesses product profiles (Kharas, 2010).

<sup>26</sup> Kharas (2010) calculated that Asia's middle class (defined as households with daily per capita incomes between US\$ 10 and 100 in PPP terms), which accounted for less than one-quarter of the global middle class in 2010 will account for over 40 percent of global middle class consumption by 2020.

<sup>27</sup> The rich and upper-middle class in China and India prefer to shop abroad, both for quality concerns as well as snob value, even for the foreign products that are available at home. The third reason for this preference, true in particular true for the Chinese consumer, is the high domestic taxes on foreign brands.

<sup>28</sup> Anecdotal evidence and market surveys in China and India do support this contention. The present day consumers in these market have unique characteristics. While the rich, even the upper-middle class, prefer to shop abroad given their snob value and quality perception, the larger mass-middle class that do aspire to buy newer products in the domestic markets remain price-sensitive. The small car "nano" that the Indian auto-major TATA group sells in India and in Europe are vastly different in their product standards, and the stripping down for the Indian market has been done with the express reason to keep the price down to affordable levels. A majority of Chinese and Indian consumers also seem to prefer the domestic produced mobile handsets even in the smartphone category to the costlier Apple iPhones, which led the company to develop the cheaper iPhone-5c handset for these markets. In fact, more and more Chinese suppliers and Western brands are now focused on China and India's domestic market, which are becoming more attractive with rising incomes and a burgeoning middle class; in the 2014 Mobile World Congress in Barcelona several established companies showed off phones priced below US\$200, in an attempt to tap into emerging markets by developing low-cost and low-tech versions of their smartphones. This development is very different from the deliberate creation of unique national standards, despite the existence of well-established global standards, which the Chinese and Indian governments are accused of for restricting imports.

<sup>29</sup> An earlier World Bank study had found that during the currency of the Doha Round, the absolute per capita income gap between the key emerging economies and advanced economies has widened further, affecting their net purchasing power and composition of products demanded.

on the credible threat of economically meaningful discriminatory outcomes that the new super-regionals can actually create and its timeline. It is thus not clear if the super-RTAs under negotiation will have any definitive influence on expanding the multilateral trade agenda either, at least in the near future.

#### **4. Conclusion**

The Doha trade talks started at a time of great political vulnerability, launched just after the 9/11 attacks in the US, and had the idealistic objective of helping developing countries. Many of these developing economies are today performing much better than the crisis-ridden OECD countries in spite of the recent growth nose-dive in emerging economies. Growth in countries such as China has skewed the balance of economic power and consequent expectations from the erstwhile poor developing countries<sup>30</sup>. Fearing that negotiating in a democratic one-country-one-vote WTO system will not allow the richer countries as much leverage as they previously had, the focus has turned to super-RTAs that are expected to generate a new momentum for liberalisation and provide a boost to trade and economic growth in particular in the participating industrialised member countries. Super-RTAs are also intended to reinforce their global influence as international standard- and rule-setters.

However, concerns have been raised that the new regionalism can succeed and provide a foundation on which an international trading regime can be built 'only if the TTIP and the TPP are balanced and open to the wider international community. Otherwise, there is the danger of creating expensive global imbalances and even market fragmentation (Palacio, 2013). Our analysis has explored one such possibility of fragmentation, in which the stated objective of global regulatory harmonisation<sup>31</sup> is not achieved because the large emerging economies choose to not move up to the higher standards because of the lack of effective demand in their domestic markets and other high-growth emerging economy markets. The changing demand patterns may in fact encourage industrialised economy multinational corporations to produce products with differing standards targeting different markets, as in the case of the Apple iPhone-5c. A healthy dose of realism about what can be achieved and by when

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<sup>30</sup> Some analysts contend that the "US is also portraying as though the emerging economies are very strong and that they can easily undertake the commitments demanded by the US" (Narayanan, 2013) and thus pushing them to adopt a leadership position at the WTO negotiations, which expectation is subverted by the fact that EMs are still the home of a large number of poor people (living under US\$ 1.25 per day) and the recent growth slowdown in these economies are further unlikely to aid the US cause in the near future.

<sup>31</sup> An interesting point to note is that the world is split between groups following US-centric and EU-centric regulations and standards, depending on the trading bloc individual countries belong to. When negotiating trade agreements (including market access treaties like the EBA or everything-but-arms and the GSP), both the US and the EU tend to impose their particular set of product standards and regulatory philosophies on their (usually smaller) trade partners.

is therefore necessary to manage expectations and retain the credibility of the new super-RTAs. These alternatives also ignore the considerable amount of work that has been done within each of the negotiating areas of the Doha Round and that the 'old' trade issues including agriculture are still of great interest (even imperative) to many of the WTO's members (Karmakar, 2013b).

So what should the emerging market strategy be? Given that the emerging countries of China, Brazil, India and South Africa are strongly constrained by domestic politics and economics from making an impasse-breaking negotiating offer, it is hard to expect definitive emerging economy leadership in the WTO negotiations anytime soon. However, in the interim, the large emerging economies can and should continue with unilateral domestic liberalisation of products and services, in self-interest and not from any threat-perception, and should also extend MFN treatment on these newly liberalised sectors, as the industrialised countries did in the early days of GATT. The same justification calls for their joining the government procurement agreement, and negotiating global competition policy rules to facilitate transparent trade and investment flows at home. The outward FDI flows from emerging economies have been on the rise in the last decade or so, and joining these global agreements will greatly benefit their domestic outward-looking firms by removing the discrimination against them in the industrial world. These can also pave the path for their eventual donning of the leadership cap and inducing global trade governance regime change.

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