The Limits of Market Power in Shaping International Regulatory Cooperation: Path Dependence and Loss Avoidance in the Trans-Pacific Partnership Negotiations

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Abstract

What factors shape the ability of the United States to negotiate international regulatory cooperation? This paper discusses three theoretical approaches that help to explain the potential for regulatory change--market power, historical institutionalism, and loss avoidance--and applies them to the negotiation of regulatory issues in the Trans-Pacific Partnership (TPP). It seeks to understand why the regulatory disciplines in some TPP chapters were more rigorous than those in other chapters. Focusing on case-studies of the chapters on state-owned enterprises and regulatory coherence, the paper argues that the market power of the United States is more likely to secure stronger regulatory disciplines when there is: (1) a strong loss avoidance coalition in the U.S. pushing for change, and (2) a weakly institutionalized regulatory framework among parties in a given issue area that makes path dependence less important.

Key Words: international regulatory cooperation, Trans-Pacific Partnership, path dependence, loss avoidance, state-owned enterprise
It is increasingly difficult to separate trade liberalization from the regulatory challenges faced by governments. The possibilities for trade liberalization are not only shaped by the regulatory environment but trade liberalization itself creates externalities that may call for regulatory responses (Epps 2014, 142). Faced with the clash between national regulatory systems and an increasingly interconnected global economy, a variety of state and non-state actors have looked to various forms of international regulatory cooperation (IRC) ranging from ad hoc consultation on proposed regulations to the actual harmonization of regulations (Hoekman and Mavroidis 2015, 3-4; OECD 2013, 22-26). Over the past decade, preferential trade agreements (PTAs) have become an increasingly important locus of such cooperation. As of April 2015, the World Trade Organization had received notification of 449 PTAs, with 262 of those agreements already in force. Of the latter group, 96 agreements addressed the topic of domestic regulation, 137 addressed competition issues, and 142 included provisions concerning technical regulations, standards, and technical barriers to trade (WTO 2015).

The most ambitious PTA negotiated to date is the Trans-Pacific Partnership (TPP) Agreement. After almost six years of negotiation, the United States and eleven other countries signed the TPP in February 2016. However, President Obama faced strong opposition to the TPP within his own party and the agreement became a favorite target of the Trump Campaign during the 2016 presidential election. On January 23, 2017, President Trump officially withdrew the United States from the TPP. This decision kills the TPP in its current form. However, the issues addressed in the TPP will not disappear and neither will the corporate interests pushing for regulatory change on these issues. While perhaps a dead-letter itself, the TPP holds important lessons about the exercise of market power and the dynamics likely to shape international regulatory cooperation over the next decade.
More than half of the 30 chapters in the TPP deal explicitly with regulatory issues. A number of scholars and U.S. trade officials have spoken to the delicate balancing act in negotiating these issues. Deborah Elms (2015, 2) suggests, for example, that several TPP chapters walk the line between encouraging fair trade and allowing members to regulate in the public interest. Likewise, former Deputy United States Trade Representative Michael Punke (Kelsey 2013, 10) explains the TPP had to strike a balance between offensive and defensive interests because any flexibility negotiated by the U.S. would be available to other members as well. It is unsurprising that negotiations amongst a diverse group of twelve countries would involve compromise. But what factors explain the balance within such compromises? Why were the regulatory disciplines in some TPP chapters more rigorous than those in other chapters? This paper argues that the market power of the United States is likely to secure stronger regulatory disciplines—defined here as enforceable disciplines that require a significant departure from the status quo—when there is: (1) a loss avoidance coalition in the U.S. pushing for change, and (2) a weakly institutionalized regulatory framework among negotiating parties in a given issue area that makes path dependence less important.

This analysis addresses two different kinds of regulatory cooperation. The first is regulatory rulemaking which involves a substantive change in specific regulations. In this type of cooperation, what David Gerber (2012, 9-10) refers to as a commitment pathway, actors agree to be part of an institutional framework, accept particular rules, and commit to a process. The second is regulatory coherence which refers to the use of good regulatory practices (GRPs) such as transparency and regulatory impact assessments in the design, implementation and review of regulations. This type of IRC focuses on the approach to the regulatory process itself rather than the substance of particular regulations.
The paper begins by discussing three theoretical approaches that help to explain the potential for regulatory cooperation--market power, historical institutionalism, and loss avoidance--and applies them in analyses of the TPP chapters on state-owned enterprises (SOEs) and regulatory coherence (RC). Although a comprehensive analysis of every TPP chapter is well beyond the scope of one journal article, these two chapters provide an important, initial test of the extent to which TPP outcomes match initial negotiation objectives. In policy terms, both chapters are representative examples of WTO-extra issues included to make the TPP a ‘21st century agreement’; this was also the first time either issue had been addressed in a comprehensive fashion as a stand-alone chapter in any trade agreement. Moreover, both address cross-cutting issues with implications for sectors addressed in several other chapters. In terms of theory-building, the two chapters provide a structured test of market power, historical institutionalism, and loss avoidance because of the role of the U.S. as the driving force behind negotiations on both issues, the contrasting levels of prior institutional development in the two areas, the varying intensity of interest-group lobbying across the two issues, and the difference in negotiated outcomes with the more extensive disciplines reached in the chapter on SOEs.

The case-studies begin with a summary of U.S. negotiating objectives as articulated by private-sector groups, such as the U.S. Coalition for TPP, and the Office of the United States Trade Representative (USTR). Next, they examine the disciplines established in the TPP chapters, the major exceptions negotiated to those disciplines, and how these disciplines compare to those established under earlier institutional frameworks including the World Trade Organization (WTO), Asia Pacific Economic Cooperation (APEC), Organization for Economic Cooperation and Development (OECD), and preferential trade agreements (PTAs). They then analyze how the path dependence established by existing institutional frameworks and the
presence or absence of a loss avoidance coalition shaped the rigor of disciplines negotiated under TPP.

**Explaining Change in Regulatory Disciplines**

*Market Power*

Daniel Drezner (2007) provides the most rigorous exposition of the market power argument. He contends that the distribution of interests among the great powers--those with the largest domestic markets and least vulnerability to external disruption--is the crucial variable shaping regulatory outcomes at the global level. In this view, the alignment of great power interests is a necessary and sufficient condition for effective global governance because the large markets of the great powers exert a gravitational pull on smaller markets. Drezner measures great power status through a range of indicators including population, gross domestic product per capita, share of global merchandise trade, and size of capital market. Writing in 2007, he acknowledges that China will likely become a more important market over time but identifies only the U.S. and EU as true great powers. If the U.S. and EU agree on common regulatory standards, he argues, relatively effective global governance is possible on almost any transnational issue. However, neither great power has the ability to coerce the other into regulatory coordination (Drezner 2007, 35-39).

Drezner provides a compelling case for the role of market power shaping regulation at the global level. But how might this approach apply in a world where regulatory issues are increasingly negotiated as part of regional or bilateral PTAs? In order to test the market power explanation as a potential explanation of bargaining outcomes within the TPP, it is necessary to establish the status of the U.S. as a great power among the TPP parties, U.S. preferences for
regulatory change, and the ability of smaller negotiating partners to forum shop. Table 1 provides an overview of key economic indicators for TPP members. The figures show that the U.S. dwarfs its TPP negotiating partners in terms of population, GDP, and the size of its capital market. Although the U.S. has a larger share of global merchandise exports than others, the margin is relatively small at a little more than double the share of Japan and triple the share of Canada. However, the U.S. share of global trade in services—the sectors most impacted by regulatory differentials—is more than four times the share of the second largest market, Japan, and more than 25 times the size of the smaller ASEAN economies in the TPP talks. Likewise, the U.S. trade-to-GDP ratio leaves it less vulnerable to external disruption than other economies and this difference is much more pronounced with regard to the four ASEAN members of TPP. Although the disparity between the U.S. and other advanced economies is less clear-cut than that between the U.S. and ASEAN partners, the market power argument still applies because, with the exception of a few notable differences such as those concerning agricultural tariffs and provisions for investor-state dispute settlement, the advanced TPP economies articulated similar liberalization preferences regarding most of the services sectors that comprised the core of the agreement.

[Table 1 Near Here] Understanding U.S. preferences for regulatory coordination is somewhat more straightforward as the USTR outlined its basic regulatory objectives at several points during the negotiations. The major U.S. negotiating goals, which will be discussed in more detail in the case studies, included securing provisions for: conducting regulatory processes in a more trade-facilitative manner; promoting transparency through more uniform rules on public notice and consultation for new regulations; eliminating redundancies in testing and certification; making
greater use of mutual recognition agreements for health and safety regulations; and negotiating rules on specific regulatory issues such as the anti-competitive practices of state-owned enterprises (Polanco 2013, 245; Shigetomi 2015, 19).

The market power of the U.S., notwithstanding, less developed states might have been unwilling to accept U.S. preferences if they could forum shop for less intrusive alternatives to the TPP such as the Regional Comprehensive Economic Partnership (RCEP). Only four of ten ASEAN members—Brunei, Malaysia, Singapore, and Vietnam—participated in the TPP talks while all ten are taking part in the RCEP talks. The participation of Brunei and Singapore is explained most easily as they, along with Chile and New Zealand, were part of the P-4 trade agreement that eventually morphed into the broader TPP. Both Vietnam and Malaysia sought to boost exports and foreign investment (Minh 2016, Lee 2015) and were prepared to undertake the degree of liberalization required by the developed economies in the TPP. At the same time, the U.S. had a strong interest in both improving regulation of the expanding trade and investment relationship with Vietnam (U.S. Department of State 2016, 3) and, according to the USTR, giving Congress a ‘more saleable’ alternative to the unfinished bilateral PTA with Malaysia (Palmer 2010).

Most important here is that the four ASEAN members that joined the TPP opened themselves to the market power of the United States, even though like other parties they tried to limit the extent of this opening by negotiating exceptions to more ambitious 21st century rules. With this understanding of great power status, U.S. preferences, and the limits of U.S. ability to assert those preferences, the market power approach suggests that the bargaining outcomes among TPP members should reflect the preferences of the U.S., as the dominant economy, for a more legalistic, hard-law approach to regulatory cooperation.
Historical Institutionalism

Historical institutionalism seeks to understand the relationship between stability and change by studying how institutions shape the interests and strategies of actors as they face changes in the external environment (Hall and Taylor 1996, Steinmo 2001). Historical institutionalists agree with rational choice scholars that actors behave in a strategic manner (March and Olsen 1989, 22) but pay particular attention to the concept of path dependence in explaining the circumstances under which specific institutions endure or break down and so allow new paths to be chosen (Farrell and Newman 2010, 616).

A major criticism of historical institutionalism is that it provides no guidance as to when path dependence will matter and when it will not. Depending on the case, external pressures may reinforce or undermine existing institutions (Drezner 2010, 792). The two different types of institutions discussed below illustrate this point by showing how path dependence can be used to support predictions of both stasis and change in the regulatory environment. Rather than trying to use path dependence as a standalone explanation of change, however, this paper characterizes path dependence as an intervening variable that mediates the relationship between market power and regulatory change. In other words, it examines the conditions under which we would expect to see existing institutional arrangements facilitate or inhibit the ability of market power to drive regulatory change.

Xinyuan Dai (2015, 4) argues that the TPP had the potential to reshape the political and economic landscape of the Asia-Pacific because it would have filled an institutional vacuum. However, the Asia-Pacific is not an institutional vacuum in terms of mechanisms for regulatory cooperation. Historical institutionalism must consider the role of path dependence in two kinds of institutions shaping the potential for regulatory cooperation in the region. The first is the
socio-cultural influence of the Association of Southeast Asian Nations (ASEAN) in the so-called ‘ASEAN way’ that emphasizes voluntarism, consensus-based politics, and the principle of non-interference. According to Jorn Dosch (2015, 7), ‘ASEAN has deliberately rejected a legalistic approach to regional integration based on stringent regulatory frameworks.’ The second consists of the formal frameworks developed in the WTO, APEC, and PTAs.

From the perspective of historical institutionalism, the heterogeneity of Asia-Pacific nations poses a fundamental challenge to the development of strong, hard-law institutions in the region. Stephen Haggard (2013, 204) sees a clear path dependence in the modest degree of institutional innovation that has shaped Asian regionalism. The foundational documents and operating principles of the two major regional frameworks—ASEAN+3 and the East Asian Summit—are firmly rooted in the ‘ASEAN way’. Kanishka Jayasuriya (2009, 339-342) offers a similar perspective on the cultural and political factors that keep ASEAN nations moving along a path-dependent course of soft-law cooperation rather than the hard law of formal treaties. He uses the term ‘regulatory regionalism’ to describe a regional preference for managing transboundary challenges through the creation of informal policy networks. The prevalence of the ASEAN way suggests that the preference of ASEAN members for a soft-law approach to cooperation could push back against the market power of the United States.

In contrast, Allee and Lugg (2016) present a view of path dependence that is defined by and reinforces the market power of the dominant state. They analyze the textual similarity between the TPP and 74 prior PTAs signed by TPP members. They find that an average of 45 percent of the text from U.S. PTAs signed between 1995 and 2015 can be found verbatim in the TPP. Moreover, the level of similarity between the TPP and U.S. PTAs is significantly higher than that for the PTAs of other TPP members (Allee and Lugg 2016, 4). The influence of U.S.
preferences is equally clear at the chapter level with the most copied chapters drawing heavily on the language used in previous U.S. PTAs; for example, the average level of copied content is 62 percent for the general services chapter and 80 percent for the investment chapter (Allee and Lugg 2016, 6). Like Arbia (2013), these authors present an activist view of the diffusion of regulatory norms in which governments champion a specific template for international cooperation and the template that prevails is determined by relative bargaining power. This paper qualifies that understanding of path dependence in two ways. First, although Allee and Lugg make a compelling case for chapters commonly found in PTAs, the TPP pushed into areas of regulation without systematic treatment in previous U.S. PTAs. In such cases, there may be no clear-cut template or the template may be a less direct expression of U.S. preferences. Second, the paper provides a more nuanced view of bargaining power by exploring how domestic politics, specifically the existence of a loss avoidance coalition in the dominant state, impacts the exercise of market power.

**Loss Avoidance**

The pursuit of regulatory cooperation can be understood in terms of bureaucratic incentives for regulators to maximize power or efficiency; the aspirational goals of national governments to address shared challenges in supplying public goods or navigating emerging regulatory domains; and private sector demand for the elimination of regulatory divergence or non-tariff barriers that limit competition (Abbott 2014, 21-22). PTAs have become important vehicles to pursue such goals because they create binding legal commitments that can be reinforced by systems for dispute settlement. Nonetheless, negotiating regulatory issues in PTAs presents challenges. Regulators will not pursue IRC unless there is a clear incentive or directive
for doing so; they are unlikely to receive credit for economic benefits resulting from IRC but would be criticized for any public harm resulting from a modification of regulations (Bull et al. 2015, 21-22). Likewise, firms may have less interest in lobbying for PTAs because it is difficult to maintain distinct regulatory requirements for PTA partners. And even when there is private sector demand for IRC, the negotiation of regulatory convergence as a binding treaty commitment may be too daunting a goal without an established record of information-sharing and trust (VanDuzer 2012, 41-44). In view of such obstacles, the private-sector’s incentive to push for regulatory cooperation needs to be particularly strong.

A conventional utility-maximization perspective suggests that securing potential gains constitutes the primary motivation for lobbying (Milner 1988). Based on experimental studies in the psychology of human decision-making, however, prospect theory suggests that people are more likely to be cautious when faced with potential gains and to take bolder action when faced with potential losses. Political scientists have applied this basic insight in studies of international economic cooperation (Stein 2003) and trade negotiations (Odell 2006). Katada and Solis (2010) provide one of the most developed applications of this approach. They examine the role of mobilization triggers and interest group cohesion in explaining the intensity and effectiveness of lobbying by Japanese interest groups across multiple sectors. They find these groups are much more likely to mobilize when the goal is to avoid losses rather than to reap gains, and that interest groups with smaller numbers and more coherent demands are likely to be more effective in pressuring government. Building on their work, this paper argues that a realized or expected drop in profit should create the strongest motivation for US firms and industry associations to lobby for regulatory change. And in the case of the TPP, which was negotiated behind closed
doors in consultation with business but not civil society groups, such interest group lobbying is more likely to send a clear, cohesive, and effective message.

**Path Dependence, Loss Avoidance, and the Limits of Market Power**

The leverage of market power is a function of both the degree of path dependence in a given issue area and interest group mobilization in the strong state. Market power will have a greater impact in pushing more rigorous regulatory cooperation when two conditions hold: (1) there is a strong coalition in the major market pushing to minimize current or expected losses, and, (2) there is only a weakly institutionalized regulatory framework or template in a given issue area. Under these conditions, the dominant power will have greater ability to expand the depth and breadth of regulatory disciplines even though the defensive concerns of all participants may result in exclusions or other non-conforming measures that limit those disciplines. In contrast, the market power approach will have less explanatory power in cases where there is no loss avoidance coalition and a more developed institutional framework of regulatory disciplines that creates a stickier path dependence. Under these conditions, negotiation outcomes are less likely to push beyond existing arrangements.

**Case 1: State-Owned Enterprises**

The state sector continues to be an important part of many economies. According to the OECD (2013, 6) roughly 10 percent of the world’s 2000 largest corporations are owned or partially controlled by governments, and have sales totaling roughly 6 percent of global GDP. Even in many advanced economies, SOEs still play an important role in sectors including energy, telecommunications, transport and banking. However, the state sector is much larger in
countries including China, Indonesia, Malaysia, India and Thailand. In Vietnam, SOEs account for roughly 40 percent of economic output (Fergusson et al. 2015, 43). Although SOEs were once traditionally oriented towards their domestic markets, they have become increasingly important actors in global trade. Many sectors with a significant share of SOEs—including those in raw materials, goods, and services—are intensely traded (Kowalski et al. 2013, 7). And this creates the potential for significant market distortions. Governments can give SOEs financial support, favor them in government procurement, create regulations that protect them against foreign competitors, and use them to advance industrial policy in strategic sectors. Indeed, over the past decade, a growing number of U.S.-China disputes in the WTO have involved SOE-related issues (Morrison 2015, pp. 30-32).

**U.S. Negotiating Objectives**

A number of business groups including the U.S. Coalition for Service Industries (CSI) and the U.S. Chamber of Commerce (USCC) pushed for SOE disciplines in the TPP. The objective was twofold: to curtail unfair practices in the TPP area that cut into existing revenues and to establish a new template that might shape future negotiations with countries outside the TPP area. It is important to note that both objectives are defensive strategies of loss avoidance rather than offensive strategies to build market share in new areas. Although any TPP agreement would be limited in reach, US firms were seeing their business opportunities reduced by regulatory favoritism and financial support of SOEs both inside and outside the TPP area. In addition to winning the support of industry associations, SOE disciplines were one of the few TPP topics to win the support of labor. The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) described SOE disciplines as ‘perhaps, the most important
area for new disciplines in the TPP’ (Fleury and Marcoux 2016, 450). Supported by a broad consensus across business and labor, the SOE disciplines were identified a principal negotiating objective within the Bipartisan Congressional Trade Priorities and Accountability Act of 2015.

Within the TPP area, the highest concentration of SOEs can be found in Malaysia, Singapore, and Vietnam. Although some SOE provisions were included in the U.S.-Singapore PTA (2004), many concerns remained regarding Malaysia and Vietnam. U.S. firms had for years criticized the opaque business practices of SOEs in Malaysia that reduced business opportunities in the country. Major targets included the sovereign wealth fund Khazanah Nasional Berhad, which dominates investment in several areas of transportation, telecom, and healthcare, as well as the energy giant PETRONAS which Transparency International has ranked at the bottom of its lists for organizational disclosure and anti-corruption efforts (Rushford 2012). In the case of Vietnam, the pivotal role of SOEs in the economy has limited opportunities for foreign investors; the government requires all foreign investment via joint-venture, often with an SOE as the only available partner (CSI and USCC 2011, 4). However, U.S. concern about SOEs also applied to developed countries within the TPP area. For example, U.S. firms had long been concerned about how the special status of companies affiliated with the government-controlled Japan Post has limited access to the lucrative markets for cancer and life insurance, as well as limited foreign access to the market for express delivery services (Corning 2016, pp. 797 & 800).

The private-sector groups that briefed the USTR in stakeholder forums sought several specific TPP disciplines regarding SOEs, including: defining an SOE as any public enterprise de jure or de facto controlled by government, requiring full disclosure about all SOEs engaged in commercial activities, prohibiting financial support of SOEs on non-commercial terms, negotiating any non-conforming measures on a negative-list basis, and making all disciplines
subject to dispute settlement (CSI and USCC 2011, 9-12; Heather and Wolff 2012, 21-27). These interests map very clearly onto the negotiating objectives set out by the USTR. While respecting the need for SOEs to provide domestic public services, the USTR sought to create greater transparency regarding SOE operations, to prevent SOE subsidies harming U.S. firms, and to minimize discrimination by ensuring that SOEs make commercial purchases and sales on the basis of market considerations (USTR 2015, 22). Fleury and Marcoux (2016, 447-449) describe the U.S. as a ‘norm entrepreneur’ spearheading a campaign to limit the commercial advantages enjoyed by foreign SOEs, and tabling the first TPP proposal for SOE disciplines in October 2011.

U.S. objectives regarding SOEs reflect a tension long visible in APEC between the free-market capitalism of the U.S. and the state-supported capitalism of TPP members like Vietnam, Malaysia, and Singapore. However, they also reflect a more specific effort to contain China even though it remained outside the TPP talks (Kelsey 2013, 7-8). The CSI and USCC (2011, 5) highlight several practices involving Chinese SOEs that have undercut U.S. firms, including: state-owned insurance firms enjoying government guarantees that allow them to take on more risk; state-owned transportation companies providing reduced rates for domestic firms; and state-owned banks providing below-market loans to other SOEs. U.S. policymakers and business groups saw the TPP as an opportunity to establish trade rules in the Asia-Pacific that could become the template for negotiations with China. Taken together, the aggressive push by U.S. industry associations and the USTR to establish disciplines for the operation of SOEs in the Asia-Pacific, with the eventual goal of levelling the playing field with China’s increasingly outward-looking SOEs, constitutes a clear loss avoidance coalition in the United States.
**Negotiation Outcomes: Disciplines and Exceptions**

Although it builds on principles found in WTO rules and some previous PTAs, the TPP was the first trade agreement to include a standalone chapter to discipline the activities of SOEs that compete with private firms in international trade and investment. The chapter does not require parties to privatize SOEs or prohibit them from creating new ones. The fundamental goal of the chapter is to force SOEs engaged in commercial activities to compete on the basis of price and quality rather than regulation and subsidies that discriminate against private competitors. In other words, to ensure competitive neutrality, SOEs must buy and sell on purely commercial terms when they are in direct competition with private firms. The focus on competitive neutrality reflects directly the loss avoidance objectives of the United States.

The SOE chapter creates obligations in three major areas: non-discriminatory treatment, non-commercial assistance, and transparency. The TPP defines non-discriminatory treatment as the better of national or most favored nation treatment (TPP 17.4) but, unlike some previous agreements that address only SOE sales within the home-country, expands the non-discrimination disciplines to include all commercial sales and purchases made by SOEs in the TPP area. The disciplines on non-commercial assistance (TPP 17.6)--subsidies, low-interest credit, debt forgiveness etc.--are a significant innovation in TPP not found in previous PTAs. These disciplines move well beyond the WTO Agreement on Subsidies and Countervailing measures which applies only to private firms and trade in goods (Yun 2016, 12). With exemptions for SOEs providing public services, the disciplines prohibit subsidies to SOEs for the production and sale of goods as well as the provision of services in a TPP country (TPP 17.6).

To bolster transparency, TPP parties must also share a list of their SOEs with other parties and, upon request, further information about the extent of government ownership or
control, revenues, and assets (TPP 17.10). The transparency rules are similar to those found in the U.S.-Singapore PTA, which contained more detailed SOE provisions than any previous PTA, but unlike that one-sided agreement also apply to the U.S. and all other TPP members (Yun 2016, 16-17). However, the chapter does allow a five-year transition period for developing country members like Malaysia and Vietnam to implement transparency rules. Finally, the SOE chapter is the only new chapter in the TPP that would have been subject to state-to-state dispute settlement and so legally binding—one of the major objectives of U.S. industry on the SOE issue.

Together, these disciplines would seem to constitute a new and rigorous regime for the regulation of SOEs. However, many exceptions noted in the chapter and annexes reduce the rigor of these disciplines. The reach of the disciplines is narrowed by the definition of SOE used, the revenue threshold at which the rules apply, the scope of activity covered by the rules, and a number of general exceptions and country-specific exceptions (Inside U.S.-China Trade November 11, 2015). The TPP defines an SOE as an enterprise principally engaged in commercial activities in which the government has effective control through majority share of capital, voting rights, or seats on the board of directors (TPP 17.1). This leaves a potential opening for enterprises in which the government is still the largest investor if not the majority shareholder.

Several major exceptions apply across the board while additional non-conforming measures are listed in country-specific annexes. Consistent with its greater market power, and a desire to maintain flexibility in responding to financial crises as it did during the Great Recession, the U.S. was able to secure what is essentially a horizontal exclusion for the financial services sector from all the disciplines in the chapter (Fleury and Marcoux 2016, 455). The broad exceptions include those for sovereign wealth funds, pension funds, enterprises entrusted with
the resolution of failing financial institutions, and enterprises involved in government procurement (TPP 17.2). The exception for sovereign wealth funds attracted particular attention because it would exempt major Asian SOEs such as Singapore’s GIC and Temasek Holdings (Lawson 2016). The chapter also included a near-blanket exception for enterprises controlled by sub-national governments (TPP Annex 17-D) which would place more of a burden on smaller unitary states like Singapore or Brunei that have only national-level enterprises.

All of the TPP parties except for Japan and Singapore negotiated schedules of non-conforming measures (TPP, Annex IV). Both Australia and Peru list only minimal exceptions while Mexico makes several exemptions related to energy and development banks. Malaysia negotiated a broad exception for all ethnic Malay, Bumiputera enterprises and a specific exception for the national gas and oil company PETRONAS. The U.S. negotiated exceptions for federal-backed mortgage lenders like Fannie Mae and Freddie Mac as well as the Federal Financing Bank, and National Infrastructure Bank. Vietnam negotiated the longest list of exceptions with 14 non-conforming measures, one of which allowed all of its SOEs to consider more than commercial considerations in the domestic purchase or sale of a good in order to ensure economic stability or the provision of public goods. Beyond this sweeping exception, Vietnam secured enterprise-specific exceptions in sectors ranging from oil and gas to coffee, mass communication, and shipbuilding.

Given the breadth and depth of these general exceptions and non-conforming measures, scholars are divided on the value of the SOE disciplines. Lawson (2016) argues that achieving this degree of agreement on SOE disciplines among 12 countries constitutes a landmark achievement. Fleury and Marcoux (2016, 455) agree that the numerous exceptions are a reasonable price to pay for the acceptance of relatively challenging disciplines by the less
developed members and would have increased the likelihood of the TPP template being applied in other PTA negotiations. In contrast, several scholars see the SOE disciplines as of limited value. Elms (2015, 4) characterizes the provisions as a ‘modest first-step’ while Scissors (2015, 6-7) sees the provisions as so weak in areas such as sovereign wealth funds that they would set a negative precedent. Perhaps most damning, Willemyns (2016, 22) asks whether the exemptions viewed as a whole ‘render the substantial provisions rather useless’.

**Explaining Outcomes: A Strong Loss Avoidance Coalition and Minimal Path Dependence**

The SOE chapter lays out a comprehensive and clear list of disciplines that are more detailed and far-reaching than those in any previous multilateral agreement or PTA and is quite transparent in listing exceptions and non-conforming measures. However, the list of exceptions is, nonetheless, extensive. The need for a diverse group of parties to balance offensive and defensive interests during negotiations explains the basic result of a compromise between disciplines and exceptions. However, the existence of a strong loss avoidance coalition in the U.S. coupled with minimal path dependence--a very limited institutional framework of SOE disciplines in terms of both rules and countries involved--helps explain the balance of that compromise.

Historically, the rules governing SOEs have been quite limited. At the multilateral level, GATT Article XVII stands as the primary mechanism for regulating the behavior of ‘state trading enterprises’ (GATT 1947). However, it covers only enterprises that enjoy special privileges or domestic monopolies and is limited to trade in goods. This limited focus on monopolies continued in early U.S. PTAs. In NAFTA, for example, the U.S. sought to challenge the position of Mexican SOEs in the energy and telecommunications sectors. By the time of the
U.S.-Singapore PTA, the U.S. moved beyond a simple concern with anti-competitive practices to broaden the definition of SOE, using effective government influence based on voting rights or management, and negotiate detailed provisions for greater SOE transparency (Yun 2016, 4). During the same decade, the OECD also began to elaborate on the concept of competitive neutrality developed in Australia during the 1990s. Unlike in the area of regulatory coherence discussed next, however, no broad-based, institutional framework for discussion of SOEs had developed that included a wide range of countries in the Asia-Pacific. This fact, along with a broad-based loss avoidance coalition in the U.S., allowed the USTR more opportunity to expand and institutionalize SOE disciplines in the TPP, albeit with substantial exceptions allowed for all parties.

Case 2: Regulatory Coherence

U.S. Negotiating Objectives

Both the U.S. business community and Executive Branch made regulatory coherence an early priority in TPP talks. The clearest and most detailed articulation of U.S. corporate interest in regulatory coherence came from the U.S. Coalition for TPP, a broad-based group of firms and industry associations from across all major sectors of the U.S. economy. In planning for the TPP talks, the Coalition’s Regulatory Coherence Working Group sought a range of binding commitments on the use of regulatory impact assessments and sector-specific mutual recognition agreements (MRAs). Rather than seeking to converge on a single standard or best practice, MRAs accept the testing and certification requirements of other countries. Such regulatory equivalence preserves regulatory sovereignty but acknowledges that different regulatory systems can still achieve the same objectives (Lester and Barbee 2013, 857-858).
The specific objectives of the Working Group included going ‘considerably further and farther than previous trade negotiations to ensure that regulatory coherence is a strategic and political imperative within the TPP’ and to ‘make certain that regulators apply regulatory best practices such as impact assessments, cost-benefit analysis, risk measurement and management, and reliance on sound science’ (U.S. Coalition for TPP 2010, 1). The Working Group also targeted more specific commitments including ‘a series of identified sector specific MRAs…to which TPP countries would have to become signatories’ (U.S. Coalition for TPP 2010, 4). It mentions, for example, the APEC MRA for conformity assessment in telecommunications equipment which was also included within the U.S.-Korea FTA. Further suggesting the potential weight of existing institutional arrangements, the Working Group recommended that TPP negotiators import regulatory best practices from existing frameworks such as the APEC-OECD Checklist (U.S. Coalition for TPP 2010, 4).

The Executive Branch was also enthusiastic about pursuing regulatory coherence. The negotiations came at the initiative of the United States with the support of Australia and New Zealand (Bollyky 2012, 171). The White House and USTR had been pushing ahead on this issue in the OECD and APEC, something they could do without needing to worry about winning support in Congress for implementing legislation. Improving regulatory coherence also promised the possibility of avoiding dispute settlement proceedings in the future because of the opportunity for advance consultation during the drafting and implementation of regulations (Posner and Wolf 2011, 3). As negotiations ramped up, the high-level President’s Export Council, a hybrid public-private body, called for the adoption of mutually coherent regulatory systems across TPP parties (President’s Export Council 2011) and the USTR proposed a standalone chapter on regulatory coherence.
Three themes emerge from the domestic U.S. discussion of regulatory coherence. First, there was a clear call for binding commitments and the application of specific tools like MRAs. Second, there was a clear path-dependence in the thinking of stakeholders. The planning documents made consistent references to work done in the OECD and APEC and called for building on those specific mechanisms. Third, although there was broad-based support for advancing regulatory coherence, there was no specific issue or sector driving the formation of a loss avoidance coalition. The objectives were framed in terms of potential gains in efficiency and quality of regulation rather than correcting the harm caused by a specific regulatory practice.

**Negotiation Outcomes: Disciplines and Exceptions**

Rather than addressing specific trade and investment issues, the regulatory coherence chapter focuses on the basic approach to the regulatory process in TPP parties. The chapter defined regulatory coherence as ‘the use of good regulatory practices in the process of planning, designing, issuing, implementing, and reviewing regulatory measures’ (TPP 25.2). Following closely the general principles laid out in the APEC-OECD Checklist, such practices include impact assessments of proposed regulations, periodic review of implemented regulations, regulatory decisions based on objective data, and provisions for public notice and stakeholder input. However, the language of the chapter makes the provisions entirely voluntary.

The list of exceptions in the chapter is also extensive. To begin, the parties would have the sovereign right to determine what regulatory measures they choose to be covered under the chapter and need only ‘aim to achieve significant coverage’ (TPP 25.1). Furthermore, they would have one year following the entry into force of the TPP to finalize the scope of the measures covered (TPP 25.3). The hortatory phrasing of the chapter continues with the provisions for
intra-party coordination among regulators. Each party need only ‘endeavor to ensure that it has processes to facilitate effective interagency communication [and] consider establishing and maintaining a national or central coordinating body for this purpose’ (TPP 25.4). The same is true regarding regulatory impact assessment. The chapter lays out detailed guidelines for the content of regulatory impact assessments but requires only that each party should ‘encourage relevant agencies, consistent with its laws and regulations’ to conduct such assessments (TPP 25.5).

There are also some notable omissions in the chapter. First, in marked contrast to the recommendation of the TPP Coalition’s Regulatory Coherence Working Group, the chapter made no mention of the mutual recognition of regulatory measures or the use of MRAs. Second, the provisions would not necessarily apply to all levels of government in TPP parties. For example, the provisions applied only to federal government regulation in the United States. And, finally, none of the provisions were subject to the dispute settlement provisions of the TPP (TPP 25.11). One might argue that the latter was needed to encourage greater participation on a wider range of regulatory measures but it drives home again the voluntary nature of regulatory coherence obligations in the TPP.

One of the early issues of debate around the ambition of the TPP was the extent to which the agreement would address inter-governmental regulatory coherence rather than simply intra-governmental regulatory reform along the lines of APEC. In response to a leaked draft of the regulatory coherence chapter, TPP critic Jane Kelsey (2011, p. 1) argued that the chapter had little to do with trade. Under the guise of coherence, the draft text targeted the bureaucratic structure and internal regulation processes of TPP members. It is clear from the provisions discussed above, however, that the coverage of regulatory coherence in the final text focused on
intra-governmental reform rather than inter-governmental coordination. In other words, the goal was to encourage the use of regulatory processes based on widely accepted GRPs rather than to require members to change the substantive nature of regulations. Thus, unlike the SOE chapter, the regulatory coherence chapter did virtually nothing to discipline the behavior of TPP parties.

**Explaining Outcomes: Heavy Path Dependence and No Loss Avoidance Coalition**

There is broad agreement among analysts about the limited results of the regulatory coherence chapter. The outcomes are viewed as ‘unremarkable’ (Ciuriak and Ciuriak 2016, 8) and ‘not particularly innovative or far-reaching’ (Sheargold 2016, 11-12). Many attribute the limited results to the diversity of the parties (Sheargold et al. 2016, 14; Bull et al. 2015, 29). More developed countries will have little interest in modifying regulatory approaches that benefit domestic producers and less developed countries will be unwilling to risk economic growth with increased regulation. This makes harmonization of regulation--and even MRAs--less likely, leaving only more shallow forms of cooperation such as information-sharing and promotion of GRPs. However, the diversity of TPP members does not provide a sufficient explanation of the less ambitious outcomes in this case because the same group of countries negotiated chapters with varying levels of ambition and rigor. The modest outcomes of the regulatory coherence chapter are better explained by both the absence of a loss avoidance coalition and path dependence in regulatory cooperation in the Asia-Pacific.

Although TPP broke new ground in treating regulatory coherence as a standalone chapter, core elements of this concept have appeared in prior agreements. Transparency obligations have a long history in trade agreements dating back to the GATT while MRAs were negotiated as part of the Australia-New Zealand Closer Economic Relations and Trade
Agreement in 1983. Perhaps most importantly, there is an extensive history of regulatory cooperation in both APEC and the ASEAN Economic Community (AEC). Both are deeply influenced by the voluntarism of the ASEAN Way and so should be decidedly less ambitious than TPP. However, this is not the case. The regulatory coherence chapter in TPP follows very closely from the work done by APEC. And the AEC, despite its modest achievements to date, has created a baseline in terms of trade facilitation and MRAs. In short, both the template provided by APEC documents and ASEAN’s socio-cultural preference for informal cooperation created significant path dependence in this issue area.

Following the failure of the Early Voluntary Sectoral Liberalization talks in 1998 the focus of APEC shifted from the negotiation of binding trade liberalization to less formal modes of economic and technical cooperation. Although many dismissed APEC as increasingly irrelevant beginning in the early 2000s, technical cooperation in APEC has progressed significantly and, as all members of TPP are members of APEC, helped inform the TPP discussions. Today, APEC provides an institutional benchmarking mechanism for member countries to engage in regulatory cooperation but, as in ASEAN, the principle of voluntarism guides the process; members make any reforms on a unilateral basis.

The discussion of regulatory issues within APEC has centered on the concept of good regulatory practices through increased transparency and public consultation, better domestic coordination of rulemaking, and more rigorous regulatory impact assessment (APEC 2014, 1-4). APEC published its first guidelines on regulatory reform in 1999, a three-page document endorsing the principles of non-discrimination, comprehensiveness, transparency, and accountability in the implementation of regulatory and completion policy (APEC 1999). These principles were fleshed out in the 2005 APEC-OECD Integrated Checklist on Regulatory
Reform. A more substantial, 36-page document, the Checklist provides a voluntary, self-assessment tool for member economies to evaluate their own regulatory reform efforts (APEC–OECD 2005, 1-2).

In 2011, APEC leaders committed to advance the adoption of GRPs across the member economies by the end of 2013. After a baseline study of GRPs in 2011, each of the 21 member economies prepared a report detailing policy developments over the subsequent two years. The results demonstrate a moderate increase in the commitment to GRPs across APEC. For example, the number of members who had adopted transparency and consultation mechanisms increased from 12 to 14 while the number of members that had implemented some form of regulatory impact assessment increased from 14 to 16. In several cases, there was also increased political and financial commitment to improving the quality of regulatory impact assessments (APEC 2014, 6).

While all TPP parties are members of APEC, the ASEAN Economic Community provides the best benchmark for a strictly Asian approach to regulatory cooperation. After more than a decade of negotiations, ASEAN members announced the establishment of the AEC at the close of 2015. However, the substantive record of accomplishment in areas like regulatory cooperation has been mixed. The most progress has been made in trade facilitation and the negotiation of MRAs (ASEAN Secretariat 2015, 11-12; ‘ASEAN Economic Community’). In the area of trade facilitation, several members have tested the ASEAN Single Window that aims to speed up customs clearance through the creation of a single interface for the submission of trade-related documents. Work is also underway on an ASEAN Trade Repository that aims to improve transparency by providing easier access to the trade/customs laws and procedures of all members. In the area of standards compliance, ASEAN has succeeded in concluding sectoral
MRAs in electrical equipment and electronics, cosmetics, and pharmaceuticals, and has begun discussions in sectors including prepared foodstuffs and automobiles. To facilitate the mobility of skilled labor, MRAs have also been concluded in eight services sectors including engineering, nursing, architecture, and accounting. Even with this progress, however, several challenges remain, including: improving regulatory coherence, legal harmonization, and a stronger regulatory framework for trade in services (‘ASEAN Economic Community’; Balboa and Wignaraja 2014, 3; Chia 2013, 22).

Although there is still considerable work to do in order to realize the AEC, it provides a well-developed institutional context for regulatory cooperation within ASEAN that, along with APEC, has created substantial path dependence in regulatory cooperation in the Asia-Pacific. This path dependence is evident both in the template provided by the APEC-OECD Checklist and the socio-cultural influence of the ASEAN way. In the absence of a loss avoidance coalition, the TPP was less able to push beyond this institutional context.

Conclusion

Drawing on case-studies of the SOE and regulatory coherence chapters in the TPP, this paper argues that the market power of the U.S. is more likely to succeed in expanding the depth and breadth of regulatory disciplines when there is a strong loss avoidance coalition in the U.S. pushing for change in an area where limited path dependence makes easier a departure from the status-quo. Of course, the analysis of two TPP chapters can only provide limited insight into how these forces shape international regulatory cooperation in contemporary PTAs. To further elaborate the argument, other TPP chapters could be analyzed. With President Trump’s decision to withdraw from the TPP, however, theory-building must also consider other agreements. One
candidate is the Trade in Services Agreement (TISA) being negotiated as a plurilateral agreement among 23 nations within the WTO. A total of eight TPP countries including the U.S. are participating in the TISA talks. Thus, it is possible that some of the services-related regulatory issues addressed in the TPP could be addressed through TISA. Although TISA has been widely criticized by labor and environmental groups in the U.S., it did not emerge as an issue during the 2016 presidential campaign. The U.S. enjoys a significant trade surplus in services and TISA excludes politically sensitive sectors like agriculture and manufacturing. As of early February 2017, the Trump administration has yet to take a public position on the talks. However, it is quite possible the administration’s disdain for mega-regional PTAs extends to plurilateral agreements within the WTO. In this case, bilateral PTAs would become the primary tool to address regulatory cooperation.

President Trump and several members of his cabinet have expressed a clear preference for bilateral trade deals. Whether such deals will be pursued is an open question but bilateral PTAs certainly seem more consistent with Trump’s fairness agenda and transactional approach to trade. In Asia, Japan might seem an obvious candidate for a bilateral deal. Prime Minister Abe’s government made enough liberalization commitments to sign the TPP, and even chose to ratify the agreement after Trump’s election. However, it is not clear that the TPP text would translate easily into a bilateral deal; the outcomes for specific sectors would change without the tradeoffs among the original TPP group and so significant renegotiation might be necessary (Leonard 2016). In any case, the bilateral would be with another developed country that shares many of the same regulatory interests; it would not achieve the goal of pushing developing economies like Malaysia and Vietnam to meet more stringent regulatory standards sought by the United States.
With U.S. withdrawal from the TPP, regional attention has shifted to the much less ambitious RCEP being negotiated among the ASEAN, China, Japan, South Korea, Australia, New Zealand and India. Rather than seeking to create new disciplines for 21st century trade issues, the RCEP is a ‘developmental’ PTA focused more on rationalizing the tangle of trade and investment regulations among members. If the RCEP enters into force, the developing economies of Asia may well have reduced incentive to seek a bilateral PTA with the U.S. that aims for the same ambitious regulatory agenda envisioned in the TPP. While U.S. business will continue to push for regulatory reform that protects its profits, and certain Asia-Pacific nations might still be open to a TPP-like agenda on regulatory issues, President Trump’s decision to withdraw from the TPP represents a major setback in efforts to advance broad, international regulatory cooperation in the Asia-Pacific.

References


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### Table 1. The TPP Economies and Indicators of Great Power Status

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