
National Economic Interests

It is often said that all politics is local. The regional initiatives examined in this study will also have to pass the test of local politics in several countries. We briefly examine the effects on participating countries beginning with the region's three largest economies (the United States, China, and Japan) and then moving on to selected issues for other countries.¹ Our discussion remains focused on economic issues, but clearly the decisions countries make will also be based on politics. The agreements are already attracting opposition in many countries; “getting to yes” cannot be taken for granted in any country. We do not attempt an exhaustive analysis of these issues, but box 6.1 provides a sampling of emerging political debates.

United States

In the two decades since NAFTA and the Uruguay Round negotiations, the United States has signed few new trade agreements and provided limited support to the Doha Round. The domestic politics of trade policy has become highly controversial, even though it is one of the few areas of policy that can still attract bipartisan support in Congress. In the policy community, there is growing concern that the United States will fall behind East Asia and Europe in deepening its external linkages (Bergsten and Schott 2010). The TPP represents a more active US strategy, designed to develop high-quality rules, attract a critical mass of partners, and eventually extend high-standard rules to the

1. Detailed results for all countries and regions will be available at our website, www.asiapacifictrade.org.

Box 6.1 Getting to yes: Domestic politics and the TPP

Trade liberalization generates widely distributed gains, but its costs often impact relatively few firms, industries, or localities. While the many recipients of gains have modest individual incentives to support an agreement, the few firms and workers that expect to be hurt are highly motivated to oppose it. The TPP too is likely to face powerful political headwinds in most participating countries. A partial list of examples from four selected countries follows.

In the United States (as elsewhere) the most contentious issue is likely to be copyright enforcement, with strong interest groups on both sides. Copyright-based industries argue for provisions that would go beyond the international Anti-Counterfeiting Trade Agreement (ACTA), while internet users and service providers strongly oppose such rules. The automobile industry supports the agreement but is strongly opposed to including Japan; it has called for commitments on US access to Japanese markets before Japan joins the negotiations. The textile and apparel industry forcefully argues for “yarn forward,” a rule that would limit TPP preferences to those garments produced in Vietnam (and possibly other countries) that use US or other regional fabrics. State and local governments—presumably with support from states-rights activists—will oppose a government procurement chapter that goes beyond covering tenders from the federal government. Numerous civil society groups argue for greater public health exemptions from intellectual property protection for pharmaceuticals. Labor and environmental groups are watching closely; the US-Colombia FTA was held up due to alleged labor rights violations. Meanwhile, the business community strongly supports a positive outcome, and general public awareness is low.

Vietnam’s political system differs from that of the United States but domestic issues will also have a large impact there. State-owned enterprises play an important role in the economy and could face significant adjustments under the competition policy chapter. (Singapore’s large government-owned investment company Temasek has also opposed additional disclosure rules.) Labor provisions calling for “freedom of association” would be difficult to reconcile with Vietnam’s single, state-sponsored labor union. Producers in several industries worry that the TPP’s environmental provisions could raise costs. As the country with the lowest per capita income in the TPP, Vietnam hopes for “special and differential treatment,” but the TPP is unlikely to include such provisions. Vietnam is projected to gain the most from the TPP and has shown flexibility on difficult issues. Much will depend on whether provisions affecting its critical textile and apparel exports are favorable enough to justify hard concessions.

Canada’s TPP debate has been dominated by “supply management” in the dairy and poultry industries and by intellectual property protection. Canada imposes quotas on dairy and poultry, with tariff equivalents estimated to run to 250 percent for dairy products. Since this issue is important to New Zealand—and likely to require concessions also by the United States—resolving it could become a prerequisite for a successful TPP outcome. With respect to intellectual property, Canada recently passed a complex copyright bill updating its intel-

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Box 6.1 Getting to yes: Domestic politics and the TPP *(continued)*

lectual property system. However, the bill is not fully consistent with proposals reportedly tabled in the TPP negotiations by Australia and the United States. These issues generate limited but forceful opposition in Canada, complicated by the diverging interests of Canada's provinces.

Japan is probably the country with the most difficult road ahead, should it join the TPP negotiations. The most important concern is agriculture: Protection levels are high, and Japan's powerful agricultural cooperatives have organized a massive campaign against the TPP. The farm lobby has been joined by the Japan Medical Association, which is concerned that services sector liberalization would erode its influence over the government-run health system by permitting private provision of health services and insurance. The government also faces difficult decisions on establishing a level playing field in financial markets served by its postal savings system. Although the TPP and other trade agreements are strongly supported by business, Japan's fragile politics and other policy challenges have made it impossible for the government to move forward on the TPP so far.

In sum, there is already spirited opposition to the TPP in most participating countries, reflecting various combinations of special business lobbies and public interest groups. These negative views also dominate online commentary on the negotiations. Significant educational initiatives and political effort will be required to build support for an agreement, regardless of its estimated benefits.

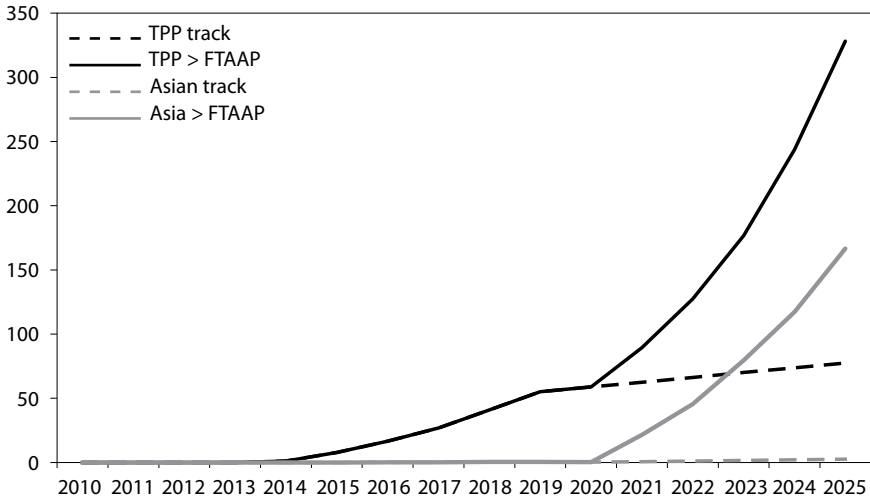
Asia-Pacific region and beyond. This would have been an ambitious strategy even when the United States played a truly dominant role in world trade, but it now has to be deployed in the midst of much uncertainty and the fragmentation of economic influence among several trading powers, including China.

The results of this study suggest that investing effort in the TPP, despite the inauspicious circumstances, is in the interest of the United States and its partner economies. If economic interests matter, the strategy should be successful in establishing a beachhead of high-quality rules. And if this template generates the gains that this study envisions, the integration effort would gain momentum and attract additional partners.

We project that US income gains under the TPP would reach \$59 billion per year by 2020 and would continue to grow thereafter, although more slowly, to \$78 billion per year by 2025 (figure 6.1, black dashed line). If the track then leads to an FTAAP based on the TPP template, US benefits would rise sharply to \$328 billion per year in 2025 (figure 6.1, black solid line). US income would be essentially unaffected by the implementation of the Asian track. The estimated income gains are too small to register visually in the figure, but they are slightly positive, suggesting that the United States will benefit slightly from the efficiency gains that Asian integration generates. If in 2020 the Asian track continues on to the FTAAP, US benefits would rise

Figure 6.1 US income gains, 2010–25

billions of 2007 dollars



Source: Authors' estimates.

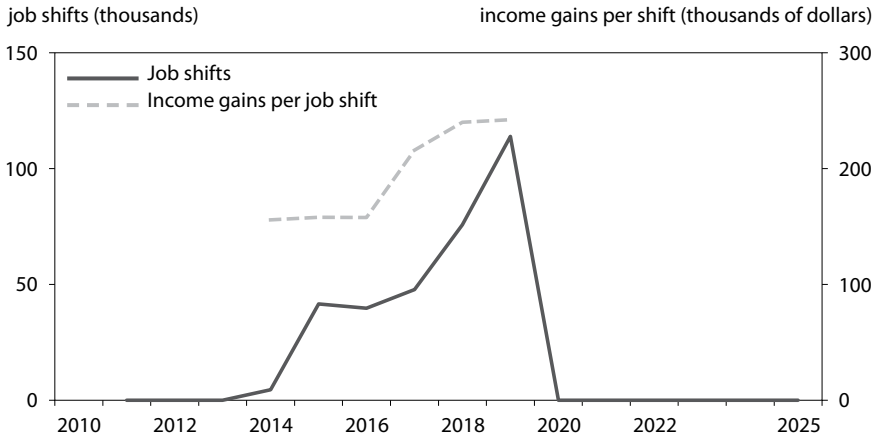
to \$167 billion. And if both tracks move forward and a compromise FTAAP is adopted, US benefits would increase to \$267 billion, in between the values attributed to TPP and Asian templates.

US exports would increase by \$576 billion, or 21 percent relative to the 2025 baseline under the compromise FTAAP scenario (table 4.2 in chapter 4).² Of this increase, agriculture and mining would account for \$31 billion, manufacturing for \$168 billion, and services for \$376 billion, the last increasing by 41 percent relative to the baseline. While reinforcing all US exports, worldwide free trade would most dramatically boost exports of sophisticated goods and services.

Given these large changes, the adjustment burdens appear to be surprisingly modest. The simulations suggest that annual job shifts on the TPP track, as defined in chapter 4, would rise to 40,000 to 50,000 jobs per year in the 2014–17 period (figure 6.2). They would rise further to roughly 100,000 jobs per year in the final two years of TPP implementation in 2018–19. For perspective, US employment levels will be in the 161 million to 165 million range in those years, and the United States will have to create 900,000 *new* jobs each year to sustain full employment. In any given year, TPP-related job shifts would affect roughly two to six workers in every 10,000 and a small fraction of

2. Both exports and imports would grow since the trade balance is assumed to be constant across trade initiatives. This follows standard theory in linking the current account balance to macroeconomic rather than trade policy determinants.

Figure 6.2 Adjustment to the TPP: Job shifts and income gains per job shift



Source: Authors' estimates.

normal replacement flows in the labor force. Meanwhile, the TPP track would generate annual benefits rising from \$8 billion to \$59 billion. For the 2014–19 period as a whole, national income would rise by \$459,000 per job shift, representing about nine years of average worker compensation for each change required. Moreover, the income gains would continue after implementation is completed and no further job shifts are required.

The FTAAP is a larger project and would impose larger adjustments. During the 2020–25 period, the implementation of the FTAAP would increase job shifts to around 300,000 annually, affecting 18 workers of every 10,000. But the average ratio of income gains to shifts would also rise, to \$539,000 per job shift, covering average annual compensation more than tenfold. Once the FTAAP is fully implemented in 2025, adjustments would tail off to nearly zero, but the benefits would continue to increase with Asia-Pacific economic growth.

The results suggest that the benefits of the TPP for the United States are significant, potentially adding \$300 billion per year to US incomes under some scenarios. While adjustments will be required to benefit from the agreements, the gains would be high compared with the adjustment burden—nine to ten times the compensation of an average worker for each worker who has to change jobs. An ultimate regionwide or global agreement would be especially attractive to the United States, multiplying its gains by a factor of three to four.

China

China's remarkable economic progress reflects bold decisions taken in the early 1990s to open and modernize its economy, leading to major market

reforms and accession to the WTO. These decisions have put China at the center of the world's manufacturing system, combining inputs from across the Asia-Pacific region and selling them throughout the region's markets. China has also begun to play a role in the region's policy architecture by proposing a pioneering bilateral agreement with ASEAN in 2002. It followed with Trans-Pacific agreements with Chile and Peru. In 2011, China also concluded negotiations on a trilateral investment treaty with Japan and Korea and is discussing launching FTA negotiations with a number of countries in the Asia-Pacific region.

Given China's scale and strategic role in the region, it is difficult to envision the future of an Asia-Pacific trading system without a central role for China. China has yet to play that role in either the global or the regional system, and its trade policies remain fluid. It has carried out most of its WTO accession obligations and has complied with WTO dispute resolution rulings, but it has not joined the Government Procurement Agreement (as envisioned at accession) or brought its influence to bear on concluding the Doha Round negotiations. China still appears to face too many challenges at home to become a major supplier of global public goods.

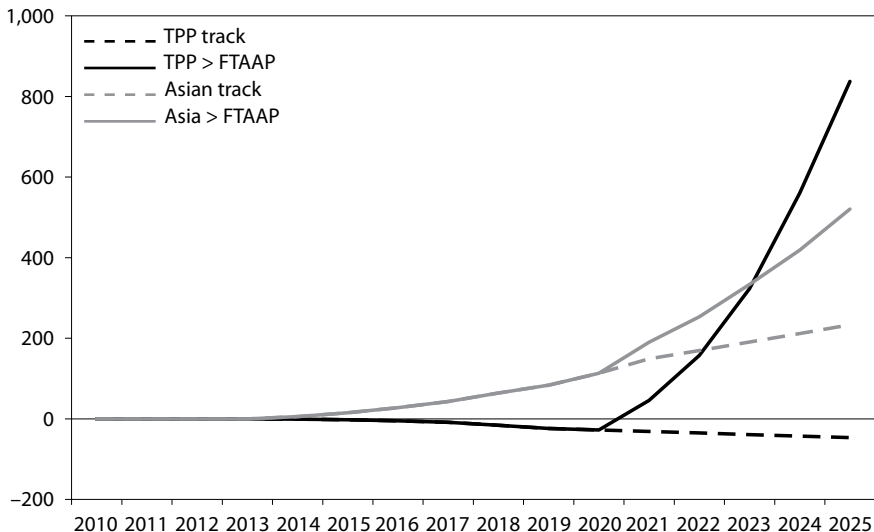
Since China and the United States are unlikely to agree on the terms of a comprehensive, high-quality trade and investment agreement at this time, the TPP and Asian tracks are likely to move in parallel for now, with the United States and China competing to strengthen these tracks. China has actively promoted the China-Japan-Korea agreement in recent years, and it has shown flexibility in the design of an ASEAN-based regional agreement, agreeing to let the RCEP proposal move forward. While interdependence with the United States is high and numerous bilateral exchanges are under way, agreement on a common policy framework appears to be some time away.

Hopefully the environment for cooperation will improve. If China's economy enters a new wave of reforms, as is quite likely, its positions may change on divisive issues such as government procurement, the environment, state-owned enterprises, and even intellectual property. Similarly, if the US economy recovers and becomes more comfortable with its "pivot to Asia," it should have more appetite for initiatives that strengthen linkages with China. In the meantime, the two economies could pursue smaller, step-wise compromises to build the foundations for cooperation in the future.

The time path of China's income changes on the TPP track (figure 6.3, black dashed line) shows initial losses due to trade diversion, rising from \$1 billion in 2014 to \$28 billion in 2020 and \$47 billion in 2025. These are the largest diversion effects calculated in the study. One part of these losses is preference erosion; China already has an FTA with most members of the TPP, which would now grant preferences similar to those available to China to the United States and other TPP partners. (Some American observers call this "leveling the playing field.") The second and more important part is trade diversion; some of China's competitors, including Vietnam, Malaysia, Mexico,

Figure 6.3 China's income gains, 2010–25

billions of 2007 dollars



Source: Authors' estimates.

Japan, and Korea, would gain preferential access to US and other TPP markets relative to China.

China's gains on the Asian track (figure 6.3, grey dashed line) would offset some of these preferences (for example, in Japanese and Korean markets), compensating for losses from the development of the TPP. Income gains would rise from \$6 billion in 2014 to \$233 billion in 2025. These gains would reflect trade creation with Japan and Korea and eventually more efficient production throughout the Asian region under an ASEAN+3 agreement. The big prize would still be a comprehensive Asia-Pacific agreement, which could be reached, as we have seen, through several pathways. Chinese gains from the FTAAP would be quite large, ranging from \$521 billion, or 4 percent of projected GDP, under an Asian template, to \$837 billion, or 7 percent of projected GDP, under a TPP template. Although the Asian template favors China's industries and thus allows China to capture a larger share of the benefits, the TPP template leads to deeper liberalization, which dominates the absolute gains.

China has a significant stake in the Asian track and especially, given its global scale, in regionwide integration. Its benefits—as those of the United States—reach their potential only with an Asia-Pacific or wider agreement, which would increase Chinese income gains by a factor of 3.6. Indeed, our simulations suggest that China would be the largest beneficiary of the FTAAP, capturing one-third of the total gains produced by the agreement. Some

Chinese commentators have recommended that China take a positive view of both the TPP and Asian tracks and promote progress toward an inclusive regional agreement. Still, the dominant reaction in China today appears to be negative toward an integration path that involves the United States.

Japan

Potential Asia-Pacific trade agreements offer Japan large benefits, but current sluggish economic growth and political uncertainty appear to be paralyzing Japanese policymaking. Japan's labor force is expected to decline by 12 percent over the next 15 years; concerns run high about adjustment, the "hollowing out" of manufacturing, and possible unemployment. Given stable or declining markets, employment in several sectors will have to shrink. The background level of adjustment under the baseline scenario is high; around 1 percent of the labor force will need to shift jobs each year. Some employment cutbacks may involve retiring workers, but there is no necessary relationship between structural shifts and retirement patterns.

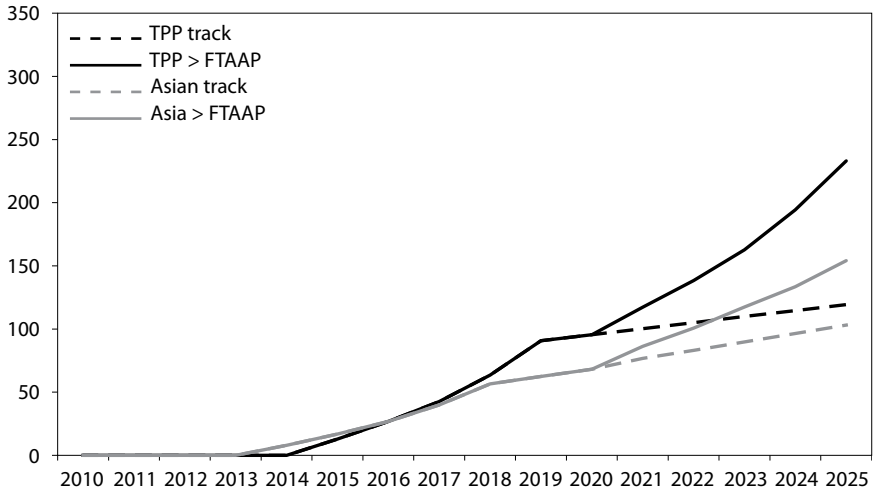
Against this background, Japan desperately needs dynamic new markets abroad, yet it is falling behind Korea and other competitors on improving its access through trade policy. Japan has an Economic Partnership Agreement (EPA) with ASEAN but not with the United States or Europe, or with China and Korea. Its business community is actively promoting trade negotiations with Asian partners and the United States.

The results of this study amply justify an active FTA policy. Both the TPP and Asian tracks generate substantial and roughly equal income gains for Japan in the neighborhood of 2 percent of GDP (figure 6.4, dashed lines). The benefits under the TPP would be derived to a large extent from inward investment and improvements in services productivity, and under the Asian agreement from goods trade, with exports increasing by 18 percent. Unlike China and the United States, Japan can potentially join both integration tracks and hence achieve substantial access to virtually all regional markets even without a regionwide agreement. The implementation of both tracks would increase Japanese incomes by nearly 4 percent of GDP. Full implementation of the FTAAP would offer only modest additional benefits, raising incomes instead by an additional 0.4 percent of GDP.

Yet both tracks face strong political opposition. In the case of the TPP, the opposition is energized by potential concessions in agriculture and other areas of economic governance, such as access to insurance and other services sectors and changes in the postal savings system. Potential membership has attracted particularly vocal political opposition. In the case of the Asian track, economic concerns are less prominent since it is expected that Japan will be able to exclude politically sensitive sectors. But there is strong concern about political relations with China, which have become more tense in recent years. Meanwhile, Japan's political tensions make it difficult to take controversial decisions, no matter how beneficial they may be in the long run.

Figure 6.4 Japan's income gains, 2010–25

billions of 2007 dollars



Source: Authors' estimates.

Japan would benefit from both the Asian and TPP tracks and the case for aggressive Japanese commercial policy is compelling. However, Japan's difficult political environment highlights the challenge of liberalization in the context of a declining labor force. Such an economy faces a high "background" adjustment burden due to slow demand and multiple declining sectors. This inevitable adjustment makes it difficult for governments to adopt policies that would require still faster adjustment, even if those policies offer the best prospects for reaching dynamic new markets. The lesson for countries that will face similar constraints in the future is to act early—it becomes increasingly difficult to make decisions that require adjustment once growth rates decline.

Other Economies

The simulations provide results for 24 world regions and produce far too much detailed information to be discussed in this Policy Analysis. The following five cases give a flavor of findings for countries other than the three discussed so far; they are far from exhaustive but illustrate important common patterns.

Vietnam would be the largest beneficiary on the TPP track and of an Asia-Pacific-wide agreement. Five factors explain this result: strong trade with the United States; high protection abroad against apparel and footwear, which are Vietnam's principal exports; strong competitive positions in these and other

manufacturing industries where China's comparative advantage is fading; high initial domestic protection; and powerful scale effects in Vietnam's principal production clusters. The first three factors boost Vietnamese exports and terms of trade under the TPP. The last two amplify these benefits by stimulating productivity gains. Higher incomes in turn enable Vietnam to invest more and grow more rapidly. Of course, Vietnam would face significant challenges in implementing an agreement that requires stringent disciplines in areas such as labor and government procurement. It also faces tough challenges in maintaining a macroeconomic environment that permits adjustment and encourages long-term investments. But overall, Vietnam's participation in the agreement is well founded.

Korea would gain significantly from all tracks due to the importance of trade in its economy. Korea has been aggressive in pursuing integration opportunities and will most likely access both the TPP and Asian tracks. Since much of its trade—including with the United States and the European Union—is already covered by FTAs, the main source of additional gains now depends on access to Chinese and Japanese markets. The Asian track provides a route to this goal, generating income gains of \$87 billion by 2025 (table 4.1 in chapter 4). With that agreement, Korea would have essentially free trade with all Asia-Pacific partners. Korean policymakers have accordingly signaled that the China-Japan-Korea agreement is Korea's next priority, although they remain interested in eventually joining the TPP because it would provide more effective rules for Korea's emerging high-technology industries. If the China-Japan-Korea agreement did not materialize, Korea could complete a bilateral agreement with China and obtain the benefits from Japan-Korea liberalization through the TPP. Through its trade diplomacy, Korea has moved ahead of most advanced countries in completing or at least launching the adjustments required by the changing global environment. Assuming Korea pursues both the TPP and Asian tracks, it will achieve 89 percent of the benefits of regionwide integration and is likely, at that point, to shift its sights to global or extraregional opportunities.

Thailand is not assumed to participate in the TPP track at this time but would see large benefits from the FTAAP, estimated at 5 percent of GDP (table 4.1). A special scenario, not reported in this study, also suggests large benefits for Thailand from joining the TPP, similar to those of Malaysia and much larger than the benefits it can obtain on the Asian track. New trade agreements would improve Thai productivity and increase exports of vehicles and electrical equipment. Like Vietnam, Thailand could make headway in building industrial clusters, including in industries that become contested as Chinese wages rise. All this suggests that if the TPP track gains momentum, and if Thailand's internal politics are stable enough to make negotiations viable, Thailand can be expected to join the TPP. Otherwise Thailand's position will be similar to that of China; short of a regionwide agreement, the TPP would put Thailand at a disadvantage compared with competitors with preferential

access to US markets. Unlike China, it is relatively free to pursue negotiations on both tracks.

Russia was not assumed to be part of either track, but as a member of APEC it would be a candidate for the FTAAP. Until such an agreement is reached (2020 in our scenarios), Russia would suffer slight trade diversion, leading to losses of around 0.1 percent of GDP. But if Russia does gain access to the FTAAP as an APEC member, its income gains would be 9 percent of GDP, one of the largest of all participants. Its exports would rise by 28 percent relative to baseline. In effect, the FTAAP would offer Russia entry into Trans-Pacific markets, as well as impose policy changes that would boost Russian competitiveness. Of course, many changes—including broad services and investment liberalization—would be required, and Russia may not be ready politically to accept such reforms. But if Russia is committed to opening its markets and building regional ties, it could emerge as the surprise champion of regionwide integration.

India was not assumed to participate in this study's main liberalization scenarios, but there are good reasons to expect that its linkages with the Asia-Pacific region will intensify. Since India competes with Asian economies in some of its production, it was projected to experience trade diversion losses of around 0.6 percent of GDP in the case of the FTAAP. More importantly, India would miss out on the domestic productivity benefits associated with liberalization and regional integration. However, deregulation and “look East” policies could put India within reach of fuller integration in the Asia-Pacific economy. These efforts could lead to regional agreements such as the RCEP, or membership in APEC and eventual regionwide negotiations. But more reforms will be needed before India's domestic policies become compatible with the expectations of the TPP or even Asian tracks. In any case, we examined adding India to the FTAAP in a special simulation and projected large gains of 6 percent of GDP for India in 2025. Moreover, adding India increased the benefits realized by nearly all other countries, by as much as one-third in the case of Singapore. Other significant winners from Indian membership would include Australia, Canada, Chile, and Malaysia. Asian economies were also found to gain, but less, since they would face more direct Indian competition.

The fine-grained results point out that all countries in the region will be affected by, and will have to respond to, the evolving TPP and Asian agreements. The details suggest potential new champions for each of the tracks and possibly striking policy changes in some countries as the tracks gather momentum. In a sense, TPP and Asian integration will jolt the equilibrium of economic relationships; their competitive consequences could include widespread competitive liberalization as well as domestic reform. The challenge lies in harnessing these energies in tracks that converge on regionwide, and perhaps global, free trade.

