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Emergent uncertainty in regional integration: Economic impacts of alternative RTA scenarios

Presentation by
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P R O C E E D I N G S

DR. SOLIS: So, hello everybody. Wonderful to have you all here and so many familiar faces. It is a pleasure really to host this roundtable for Professor Kenichi Kawasaki.

Professor Kawasaki is at the National Graduate Institute for Policy Studies. He's also a Senior Fellow at GRIPS Alliance and a co-chair of the Global EPA's Research Consortium, and the list continues.

He's also a Consulting Fellow at RIETI, the Research Institute of Economy, Trade and Industry and Adjunct Fellow at the Japan Institute for International Affairs.

Today he's going to talk about the economic impact of alternative regional trade agreements. I've been for a very long time fan of Kawasaki-sensei's scholarship. I think that he has provided some of the most useful analysis of what are going to be the different impacts from Japan's trade agreements and he has a very interesting recent study that he's going to share with all of us today.

I should note that we have a semi-public format in the sense that Kawasaki-sensei's presentation, we'll make a recording of that. There will be a transcript. I think he will allow us to post the slides, I'm not sure if he will, on our website, but then the Q&A and the conversation with all of you, that remains private so that you can share very candidly your views on where we're heading in terms of trade agreements. I imagine those views will indeed be candid.

So without further ado, I'll let Professor Kawasaki make his presentation and then we'll open it up for Q&A and discussion amongst all of us. Thank you.

DR. KAWASAKI: Thanks, Mireya, for organizing this seminar this afternoon and thank you all for coming. But before starting let me thank Mireya again.

I have written my studies in January, targeted to make it public on the date of January 20, the first day of Trump. Also, I sent out my paper to many of Japanese media friends, but no report on newspapers. But Mireya made a seminar in mid-April at Japan Center for Economic Research. After that, Japanese media people rushed to come to me to give the numbers because Mireya touched upon my estimates on that. So what I'm say is Mireya is so impactful in Japanese society, that's why I have been so successful to be shown and honored in the media and others.

So, what I'm going to discuss this afternoon is quantitative impact of several regional trade agreements using economic model simulation.

You know quite well, but if I give you one key word talking about regional integration RTAs at this moment, that is definitely uncertainty. What this means? June last year, the UK decided to leave from European Union. After that, you have elected a new president proposing some different trade policymaking.

GUEST: A little different.

DR. KAWASAKI: I know your work on TPP --

(Laughter.)

DR. KAWASAKI: Actually, I was with the Japan government TPP headquarters office until mid-2014, 2015. So uncertainty here. What this means for policymakers? Policymakers need to consider alternative scenarios for RTAs, not just TPP but other TPP 11 or Japan-U.S. bilateral.

Then, what this means for we the economists? We the economists need to analyze various RTA scenarios, not just one scenario but alternative scenarios. So that makes us very

busy and I'm now very much excited doing this business. I'm sorry to say past negotiator may have some difficulties, but we the economist are very much seeing such an exciting moment to study various scenarios, rather than just one or two.

So that said, this is an overview of my discussion this afternoon. The first key issue is to discuss U.S., Trump trade policymaking, saying that U.S. would no longer gain and even lose once withdrawing from TPP, and the benefits of a bilateral FTA with Japan would be smaller than those TPP.

Talking about China, China would lose seriously if the U.S. imposed a higher tariff on imports from China, either unilaterally or bilaterally. China's benefit from RCEP might be relatively limited if it is on the level of the agreement.

Sadly, I don't know if it will be of interest to you or not, but UK's cost of Brexit could be smaller than the possible benefits from joining TPP. I have talked to UK government guys—live in EU but join TPP.

So that is overview of my discussion this afternoon, but before starting let me give you a couple of key observation in Asia-Pacific wide trade agreements. The first is why TPP, FTAs, RTAs are so important in Japanese society or Japanese economic policy making, first.

This is to give you some idea of the impacts of EPA. The bottom line is the impact of structural reform measures, including FTAs, economic partnership agreements, EPAs, would be achieved over medium term and contributing to sustainable growth. The key word is sustainable growth.

You have often heard our Japanese Prime Minister Abe's three arrows economic policy making. First arrow, financial monetary easing is quite efficient, adjust business cycle. Right? The second arrow, fiscal stimulus, is also quite effective to boost standard economy in the short-term horizon. But once monetary expansion, fiscal expansion will be removed, then the impact will disappear. But the third arrow, structural reform measures, the impact would be sustainable over the medium and long term horizon, according to the more efficient resource allocation or productivity improvement.

So the first arrow, second arrow very short lived developed impact, but third arrow, structural reform measure, is sustainable over the medium term horizon. That's fine, in my view. The third arrow, structural reform measures, including EPA, TPP policy measure could be core key element of Japanese government economic policy making.

So let me again say, underscore the fact that TPP and FTAs are important in terms of economic policy making, first, but you guys may also be interested in geopolitics in Asia-Pacific wide.

So this gives you the idea of the current framework of leader trading relations in Asia-Pacific wide. You may well know that the two major vehicles here, one is TPP and then another is RCEP, East Asian comprehensive economic partnership agreement.

Just note that Asia-Pacific economies are divided into four groups. One is a member of both RCEP and TPP, like Japan; two is a member of TPP, but not yet RCEP; and three is a member of RCEP, like China, but not yet TPP; and fourth are not a member of either TPP nor RCEP. So far, Russia, Hong Kong, Chinese Taipei, but now U.S. is joining this fourth group of not a member of TPP nor RCEP. This is my headache.

The first figure here is to estimate the impact of Asia-Pacific EPAs to compare several scenarios, TPP 12, including U.S.; RCEP, East Asian EPA; and then FTAAP, Asia-Pacific-wide EPA. In terms of impact, in terms of real GDP, on APEC economies as a

whole.

The first point I'd like to make here is the real GDP gains from FTAAP is larger than TPP and RCEP. So that's why I have often said that TPP and RCEP are more likely complements each other, rather than the competitor of the other, toward final goal of Asia-Pacific-wide EPA, that is FTAAP.

In Japanese society often we were asked whether Japan should prioritize TPP led by U.S. or RCEP led by China. My brief answer to that question is not to choose one from two, but choose two from two, then we can maximize our economic benefit. That's why we're not just keen about TPP but also RCEP and FTAAP.

The second point I'd like to drive -- key point from this figure is the impact of nontariff measure reductions is much more sizable than just tariff removal. In particular in the case of TPP, vast majority of economic benefits are given by nontariff measure reductions. That's a new 21st century regional trade agreement, rather than just 20th century old, traditional tariff removal economy.

Just note that we cannot conclude from this figure that RCEP gain would be larger than TPP. RCEP is not yet concluded. I have assumed hundred percent tariff removal and 50 percent nontariff measure reductions equally in the case of TPP and RCEP. Depending on the level of ambition achieved in the RCEP negotiations, the impact could be smaller than this estimate. So that's why it is too early to conclude whether TPP, RCEP benefit more or less.

So one -- another key figure is to estimate contribution to such a real GDP or macroeconomic gains by member economies of Asia-Pacific, APEC. Something like a ranking of contribution to economy benefits.

Who will generate the largest GDP gains of APEC economies as a whole? That would definitely be China. Second, U.S. I'm sorry to say U.S. is not number one here, but number two. Japan is ranked number five here. We cannot have gold medal, silver medal, or bronze medal in this ranking. China, gold medal; U.S., silver medal.

Why China first, U.S. second? There are two key determinants. One is a positive side; that is, size of economy. China, U.S. are the largest two economies in Asia-Pacific, that's why China and U.S. larger income gains than others. So this is the positive.

But then, why China could generate larger gains in comparison with U.S.? Right? There could be second element, that is the current level of tariff and nontariff measures (NTMs). U.S. has lower tariff, U.S. NTM level is also lower, but China joined WTO later and Chinese level of NTMs at this moment could be higher than OECD average.

So that's why when I often present this figure in China, China people love to see this figure. Oh, China ranks number one in the Asia-Pacific! That's one side of the economy. But this is not a ranking of a beauty contest, this is something like a ranking for future task or homework. Right?

But what I'd like to say here is success of economic benefits in Asia-Pacific free trade agreements is very much dependent on China, whether China will significantly reduce their tariff or nontariff measures. Also, talking about the relative importance of several scenarios, RTAs, economic impacts of Asia-Pacific is very dependent on whether China is included in that framework or not. So that's why China should be looked at more in terms of generating larger or smaller economic benefits.

So that said, today's key figure, that is to compare the economic impact of couple of TPP scenarios on U.S.

The first point is once U.S. withdraws from TPP, meaning TPP 11 here, that may

be discussed at APEC Trade Ministerial Conference on the date of 20th of this month in Ha Noi. So now Japan and Asian societies very much keen about whether TPP 11 negotiations or review could be installed or not toward APEC ministerial. Once U.S. withdraws from TPP, the impact of tariff reduction should definitely be negative due trade diversion effect. You can imagine, Japan has already concluded bilateral FTA with Australia. Now, if you go to Japanese supermarket, more Aussie beef rather than U.S. beef. If U.S. could be in TPP, then our Japanese import tariff on beef could be cut. That's why the imports from Australia and U.S. could be balanced. But once U.S. withdraws from TPP, Japanese guys may continue to buy Aussie beef, New Zealand dairy, or Chile wine, but no longer U.S. beef or California wine, so that's trade diversion effect. That's why U.S. could likely lose once withdraws from TPP.

Then what could be impact on U.S. from Japan-U.S. bilateral FTAs or EPAs? According to my estimate, U.S. gain, even including nontariff reduction -- NTM reduction, would be around half of TPP as a whole.

So the point here is U.S. macroeconomic impact, in TPP 11 U.S. will lose and then bilateral Japan-U.S. that could be just a half from compared with TPP.

GUEST: Forgive me if I missed it, what's the time frame for this?

DR. KAWASAKI: There's no say – time horizon here. This is the compare the two states, one is without TPP or RTA scenario. The two is once such an TPP or RTA could be implemented sometime in the future. So we are saying this impact could be realized over the medium term horizon, say ten years later or -- not next year or tomorrow. Just to compare two steady states (inaudible) period, according to this one.

So, then what's the case on Japan? Japanese real GDP gains from tariff reduction of TPP 11 will be very much smaller than TPP as a whole because from Japanese perspective, U.S. is the major trade partner in TPP. So that's why as far as the impact of tariff reduction are concerned, Japan may not gain much from TPP 11, once U.S. withdraws from TPP. But including the impact of nontariff measure reduction, real GDP gains of Japan from TPP 11 or Japan-U.S. bilateral is not so much less than TPP as a whole. So this is another key point I'd like to note here.

Again, from Japanese perspective, TPP, TPP 11, Japan-U.S. not so much different. We could survive -- we are fine with all three scenarios. But in case of U.S., U.S. could be happy with TPP but not TPP 11 or Japan-U.S. So I'd like to ask your president why U.S. do not choose TPP --

GUEST: The TPP 11 bar for NTM reductions, there the U.S. still gains from that?

DR. KAWASAKI: Yes. That is one key point I'd like to say, yeah. In case of tariff reduction, that really applies just with the member of trade agreement. But in case of nontariff measure reduction that would apply to third countries, added MFN (most favored nation) basis.

In case of TPP agreement, mutual recognition of safety conformation of pharmaceutical work, that will apply just within the TPP members' laboratories. But extension of say copy rights or intellectual property rights, that is allowed -- not just from, you know, written in China or Japan or U.S., we cannot discriminate such --

So that's why nontariff measure reduction may have more such an MFN basis feature. That's why that will be applied to the other countries. That is also one good reason why Japan could expect to gain large enough from just Japan-U.S. bilateral or TPP 11 that U.S. withdraws from.

In case of tariff reduction, U.S. is so dominant, generates Japanese real GDP gains. But in case of nontariff measure reduction, due to such an (inaudible) basis, third party spillover of effects of nontariff measure reduction --

GUEST: This is assuming that the TPP 11 keeps the same provisions as in the TPP and that the bilateral also is the same --

DR. KAWASAKI: Yeah, same, yeah. That's one key assumption, yeah.

GUEST: I understand the tariffs--the blue. Explain to me once again why the NTM bars are so close in size.

DR. KAWASAKI: Yeah. U.S. share is say 50 percent or 60 percent in Japanese export market or trade market, right? But the remaining 40 percent market, Canada or Mexico, we can expect the economic impact from NTM reduction as well. So that's why it is not just U.S., but the spillover effect to other country that Japan can enjoy. That's why from the Japanese perspective, even Japan-U.S. bilateral agreement, the spillover effect with third countries—Canada, Mexico, Australia, or others—Japan could gain more than just applying to the U.S.

GUEST: So are you saying -- the Japan-U.S. nontariff measure bar seems really high to me. You're saying, just if we do a bilateral with you, there's no TPP 11, those are the gains?

GUEST: Because then the benefits are mostly coming from third countries, which you just mentioned. They would be coming straight from bilateral trade.

DR. KAWASAKI: So I have included all the case such as third country spillover effect here. So in case of TPP 11 in comparison to TPP 12, even U.S. is not a member of TPP 11, Japan may apply say 50 percent or some part to NTM reductions in case of imports from U.S. In case of Japan-U.S. bilateral, large parts and major part of NTM reductions apply just between two, Japan and U.S., but the third country effects apply to the rest of the world, including non-U.S. TPP member countries.

But why U.S. gains from Japan-U.S. bilateral is so smaller than TPP? That is because looking at U.S. trade or export market, your trade is more with say Canada or Mexico, and Japan's share is just less than 20 percent in U.S. export or trade market. So that's why the gains from nontariff measure reductions is very much smaller than TPP.

GUEST: Is some of this also driven by an assumption that existing nontariff measures in Japan are relatively high, so removing those barriers like on the import side and gaining efficiency in the domestic market in Japan is increasing a lot, no matter which of those scenarios you look at?

DR. KAWASAKI: So there are two here. If you are keen about the absolute magnitude of GDP gains, it is very much dependent on the level of NTM and to an extent how NTMs could be reduced. But if you are interested in comparison of those three scenarios in case of Japan or in case of U.S. or in case of Japan, that big picture -- meaning let's see difference in case of Japan from these three scenarios and very much different asymmetric impact in case of U.S., that would remain unchanged. Either the level of absolute magnitude of the real GDP gains could be smaller or larger, according to level of NTM reduction. The spin-over effect remains the same among these scenarios.

I may come back later, but let me move onto other points of these key parts of discussion --

(Computer difficulties).

GUEST: Kind of like U.S. trade policy.

DR. SOLIS: That's a good one.

(Laughter.)

GUEST: I have a quick question, on the NTMs, how did you measure NTMs? What does that represent? A lot of times it's one of the most difficult things to measure, so I'm trying to get a sense of how -- what that includes.

DR. KAWASAKI: There are a couple things I need to clarify. But, first, I have used estimates by World Bank and UNCTAD economists. They have estimated TRI, that is Trade Restrictiveness Indices, in terms of AV, ad valorem equivalents, of tariff estimates. The methodology is applying the so-called gravity model estimation, that is, if two economies are close to each other, we can expect more trade than the case two economies are located far each other. But if two economies trade less than that gravity model estimate, we say there should be some tariff barriers or nontariff measures, which may restrict more trade than otherwise case.

So that econometric studies gives us some level of NTM estimate, but that includes all nontariff measures, not just SPS, TBT, technical barriers, or safety standard of food, but expected to include say some procurement restrictions or competition policies, IPR, labor standards, environment, all are potentially expected to be included in that estimate of nontariff measures.

But it is still undergoing study, that's why I myself have proposed set up a global FTA or EPA research consortium co-chairing with Peter Petri, you know quite well, of Brandeis, and I, myself, now co-chairing and having experts from international organizations like World Bank, OECD, WTO, and national economist including U.S. ITC or Japan government. Now we are working together to improve and update such NTM estimates.

It has partly been used by U.S. or Japan or Canadian government estimates of TPP impact, but not yet well finalized, so it's still undergoing difficult study, because, you know quite well, tariff is visible always in terms of numbers, but NTMs are not visible in terms of numbers.

DR. SOLIS: We apologize. The technician is on his way. I don't know if you want to continue or if you need the slides --

DR. KAWASAKI: It's better to use slide, because it's easier to view. Without slides, I may give you key points as I've already touched upon at the beginning.

DR. SOLIS: Thank you.

(Recessed)

DR. KAWASAKI: Let's quickly have a look at the remaining slides.

The second issue is estimate impact of U.S. higher tariffs on China or Mexico. The impact on U.S. here, U.S. would definitely lose once imposing higher tariff on imports from China or Mexico, either unilaterally or bilaterally. So I'd like to say that, you know, protectionists cannot say (inaudible) of U.S. at the macro level. They could say (inaudible) of some limited auto parts or others, but at the macro level, U.S. would likely lose rather than gain when imposing higher tariff either on China or Mexico. The magnitude is very much sizable in comparison with expected gains from U.S. remaining in TPP.

And impact on China, that is also sizable, though estimated to be minus three percent of real GDP. If China, Japan, East Asia could conclude RCEP, say hundred percent tariff removal and 50 percent nontariff measure reduction, that could be very much ambitious expectation than reality, but that in comparison with those very ambitious gains ranging from one to two percent possible real GDP growth in China from U.S. imposition of

import tariff from China is larger. So that's why from Chinese perspective, in order to offset such an headwinds from D.C., U.S., China need to work more on RCEP negotiation and need to achieve higher trade liberalization, otherwise they cannot offset headwinds from D.C. or --.

Lastly, third issue is to estimate the impact of Brexit on UK and others. Much remains to be seen in reality, how border measure will be re-set-up between UK and remaining European Union. But simply assuming tariff cases, two assumption here. One is reintroduce MFN, WTO basis tariff at the border of UK and EU, or EU would reintroduce tariff as if currently existing in a border of EU and Norway, or Switzerland -- I'm saying here EFTA type tariff setting. But either two cases, UK would lose either one percent or 0.2 percent here, a sizable impact just from the reintroduction of tariffs here.

Then that negative impact could be compared with some possible gains from FTA between Japan and UK or U.S.-UK and then UK joining TPP. In comparison with the possible negative impact of Brexit, UK cannot offset that negative impact just having FTA with Japan or U.S. But once joining TPP, UK benefit would more than offset negative impact from Brexit-EFTA cases. That's why I have said UK should join TPP rather than remain in EU expecting to gain more, but one big if here, my study has assumed U.S. remains in TPP. So once U.S. withdraw from TPP, that expected gain could be smaller. So that's why in order for UK to enjoy more benefits joining TPPs and EU, U.S. must remain in TPP here.

But if I could joke here, I cannot say this in continental Europe, but may I ask how many European Union countries speak English as their national language? How many TPP countries speak English as their national language, having Queen's English? So more--

(Simultaneous talking)

DR. KAWASAKI: Yeah, Australia, New Zealand, Canada. So more English speaking societies in TPP. So that's why if I were Brits, I may feel much more familiar joining TPP rather than remain in EU.

The point here is language could be a bit key element of trade and business. I think the business guys here, you know. But trade between English speaking societies or say Spanish speaking societies could be much more frequent than other cases.

So, if I give you one figure, looking at this figure, for example, UK share 15 percent in Japanese export market in European Union as a whole. In case of U.S. and Japan, the estimated impacts are quite similar each other. Once UK leaves from EU, U.S. or Japan expected to gain from tariff reduction could be 15 percent smaller than the case UK remains in EU. And bilateral gain from U.S.-UK or Japan-UK tariff reduction is 15 percent of U.S.-EU or Japan-EU as a whole FTA cases. So trade in goods is 15 percent, that is the share of UK in the EU market. But if you look at market of Japanese foreign direct investment in EU, UK share is more than 50 percent. UK or London is a first destination of Japanese business to go overseas in EU.

I don't know exactly the case but if we go to France or German or Spanish or other continental European countries, we need to study and speak not English, but French, German, or Spanish. Even for Japanese guys, English could be familiar than other language. So that could be one key element for determination of the destination of foreign direct investment, for that we need to go overseas in the market entry and other -- so language could be one key element of trade. So that's it.

In case of U.S., tariff removal, UK share is 15 percent importance here. But again, in case of NTM reduction, because of expected spillover effects to third countries, the impact of UK leaving from EU is not so much important in the case of nontariff measure reduction in

comparison with the case of tariff removal, for that U.S.-UK gained 15 percent of U.S.-EU EPA, but U.S.-UK bilateral NTM reduction could still generate 60 or 70 percent of U.S.-EU as a whole TTIP economy.

So I will stop here and respond to your questions. Not so difficult ones, I hope.

DR. SOLIS: Thank you very much, Kawasaki-san, for that great presentation and I really appreciate your patience as we worked through the technical issues.