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“All about the Trans-Pacific Partnership”
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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast "Dollar and Sense." My guest today is Mireya Solís, the director of the Center for East Asia Policy Studies at Brookings and a leading expert on the Japanese economy and Japanese politics. Welcome Mireya.

SOLÍS: Thank you, David, it's a pleasure to be here.

DOLLAR: Our topic today is the Trans-Pacific Partnership. It will become effective on December 30th, 2018. So I just want to start with the most basic question? What is the TPP? How did it come about?

SOLÍS: The TPP has had several lives, actually. It started a small trade agreement. It had a very technical name. It was just known as the P-Four and it was an agreement among small economies, all APEC members, open economies countries like Singapore New Zealand and so forth.

Then it got a major push when the United States decided to join. And that really transformed the significance of the TPP. That was in the last few months of the Bush administration and then the Obama administration. It took a year to review trade policy but eventually came to see this as a major driver of its economic engagement in Asia but also in the broader Asia-Pacific region.

So you had 12 countries eventually negotiating and finally succeeded in coming up with an agreement in 2015. And the next life of the TPP was when the United States left and that for the 11 members it was about what do we do next. Do we carry on with these negotiated trade agreement even though the largest economy is no longer here? Or do we call it quits? And they decided to continue.

DOLLAR: If I could just pause you right there, I remember when the United States decided to pull out, most trade experts thought that the TPP would fall apart but Japan apparently stepped up and played a leading role. Talk a little bit about that.

SOLÍS: Very interesting to watch. I think right after President Trump in January

2017 announced that the United States would no longer be a member of TPP, all bets were that this meant the end of the agreement, that there would not be the need of leadership, that it would not have the economic heft and therefore that the agreement would now be put in a drawer.

And I have to say, David, that Japan did not immediately jump at the opportunity to advocate for a relaunch TPP. It took a few weeks. It took adjustment to the idea, but eventually they decided that they were better off making sure that TPP survived for a number of very important reasons. I think for Japan it's an economy that depends very heavily on the global supply chain for its economic prosperity and the TPP has a new rulebook that's best attuned to the operation of the global supply chain.

I think that for Japan it was also the calculation was we want the United States back and the best way to guarantee is to make sure that this template for trade agreement that the United States really championed survives. And eventually it became also useful to make sure that it would not just be China who is putting new initiatives on the table for economic integration but also that there are a different set of standards and that Japan is also very much seen as a shaper of economic integration in the region.

DOLLAR: So as I understand it some of the provisions of the TPP were suspended but basically nothing was changed so if the United States changes heart and decides to join in some part of the agreement that was negotiated is there. Is that right?

SOLÍS: Yes, they were very clever about how they did this. They changed a number of things. Very importantly, the first thing they changed are the conditions under which the TPP can be ratified. The original TPP, you had to have the United States signing on to ratify and for these to go forward. But now they simplified the rules so that you only need six countries to ratify. And now seven have done so.

Then they decided instead of eliminating whole chapters—this was something that the Japanese insisted on because they wanted to preserve the spirit of the TPP order to

facilitate an American return—is that they were going to go for a suspension. So nothing has been eliminated. But some things have been put in brackets and again they have been put on the shelf for the time being.

These were issues mostly that the Americans were championing and they were not popular with the other TPP countries. But the suspensions are narrowly defined and they have to do mostly with intellectual property issues. Some narrowing down on the implementation operation of the so-called investor state dispute settlement mechanism.

And again the majority of the agreement remains as it was.

Now it doesn't mean that the United States knocks on the door and says we want back and everything just snaps back. I think that it's very important to understand that if the United States wants to come back some TPP countries are more comfortable with the new provisions, the suspended ones, and they may want to renegotiate with the United States and not just automatically give it to them.

DOLLAR: Very interesting. So it's a big trade agreement. This involves tariff cutting for trade in goods and then lots of nontariff measures so let's start by talking about the tariffs what's happening to tariffs among the 11 countries that are in this implemented TPP?

SOLÍS: Big rush of liberalization right away. The TPP, as you mentioned, enters into force on December 30th. And that means that a very substantial amount, something like an average 90 percent of tariffs are either cut or eliminated, and then that starts the process whereby you begin to draw down on the remaining tariff lines. So much so that by the time the entire process is done you will have time for elimination for most countries in the 99 percent level. And Japan actually here does not look that great because they have their cultural sensitivities. And for Japan is actually going to be 95 percent tariff elimination when the entire process is finished.

So for some of the most sensitive sectors we're talking about a period of 16 years

for example beef and so forth. But there's going to be a lot of tariff elimination right away. And then a lot of progress in the next five or six years and only the most sensitive issues you're talking about a protracted liberalization.

Now let me just make one last point here. Think about the contrast between all these economies slashing tariffs across the board and what we've been seeing in the U.S. and China trade dispute where you actually see tariffs being implemented and escalating rapidly, so the contrast could not be sharper than this.

DOLLAR: So you mentioned Japan is going to continue to protect its agricultural sector to some extent. But I read that the beef tariff is going to drop to I believe it's 8 percent and the U.S., which is not part of this agreement, is going to continue to face 38 percent I believe so, the U.S. is going to be missing out on some of these new market opportunities.

SOLÍS: Completely and American beef producers are keenly aware of that. Now that tariff is not going to drop down immediately again because it's a sensitive sector for Japan I think that they're talking about a 16 year transition period. But nevertheless you know if you go from 38.5 to 9 percent, I think, that means that Australians, for example, are going to be better positioned and that applies to beef but applies to other agricultural products.

So much so that you know how that will play out when there are econometric studies about the gains from the TPP and the TPP in its different configurations, some of the remaining countries are going to be better off with the TPP 11 than they were expected to be with the TPP 12 precisely because they will not face the competition with American producers and therefore they'll be better positioned in the very lucrative large Japanese market.

DOLLAR: So let's talk about some of the nontariff elements of TPP. I remember as TPP was being negotiated one thought was that some of this was directed against China.

China is not part of the original 12, it's not part of the 11 that are implementing the TPP, but some of the chapters that were developed address trade issues that have been raised by China's performance so let's talk about what are some of the important chapters or issues in the TPP 11.

SOLÍS: China has always loomed large in the TPP process. One way to describe it the term I've used these to think about China as a shadow negotiator in the sense that they did not sit at the table, they don't have to abide by TPP rules because they're not members, but certainly it is Chinese trade practices that very much informed whether it be countries were trying to negotiate.

There are two areas that I would highlight, David, where I think this is very important. One is on the chapter on state owned enterprises. As you are far more knowledgeable than I am, there's a lot of discussion in trade policy circles about China's state capitalism practices and as to whether state owned enterprises derive unfair advantages because they might be receiving subsidies and other benefits from the government. So what the TPP does in this chapter, very importantly, is that it comes with a definition of what a state owned enterprise is. And it's not just that the government has majority ownership. If the government has an ability to control the operation of these commercial enterprises, say because the government can appoint the board of directors, then they qualify. They're going to be subject to these disciplines.

Very importantly now they have to come up with much more intrusive reporting requirements so they have to provide information to the other countries as to what are the enterprises, what activities, all of these issues that will be important to be monitoring the actions and make sure that they're not distorting the market. And there there's an obligation established in the SOE chapter in the TPP that these state owned enterprises cannot behave in a way, or governments cannot provide subsidies to these enterprises, in a way that harm the interests of the other TPP countries. So the idea is to begin to really

tackle this issue that is creating a lot of friction where we don't have existing rules in other platforms like the WTO or other trade agreements and begin to bring disciplines that can effectively level the playing field.

DOLLAR: Right. So this state enterprise chapter is going to be particularly relevant for a number of members. Two of those poorer members of this club are Malaysia and Vietnam, Vietnam especially. It's a communist country, it's a mixed economy, it has lot of similarities with China. So it's going to be interesting to see if this state enterprise chapter of these procedures can really discipline their behavior.

In Vietnam's case as a relatively small, poor economy, they've made a choice to live with these disciplines in order to have better access to this large market of Japan and the rest of the TPP 11. So, China of course is much bigger. Not clear China will make the same kind of decision anytime soon but it will be interesting to see how well this works out. What about some of the other chapters?

SOLÍS: The other chapter I would bring to your attention is the e-commerce or digital economy chapter. Again the idea is that you want to codify rules that cover the cutting edge in terms of where these economies are heading, where the center of economic activity is. And we don't have these rules in the WTO, we don't have very significant rules in other trade agreements. And the TPP provides, I think, some rules that are really important in this domain.

One of these rules, for example, is to establish freedom of data flows, and we know that this is going to fuel a tremendous amount of economic activity and this is only going to grow as we go in this direction. The other very important provision of the TPP is that it forbids countries from establishing what we call localization, data localization requirements and that is that you have to keep that data stationed in that economy, that you cannot allow it to go to other countries.

There's also a provision on demands for source code, and this is also a practice

that is very much criticized and China's usually mentioned. That the government pressures companies to relinquish very critical information, technological information, source code, and that companies, private companies should not be asked to do this.

But also importantly looking at the other side of the coin, David, the TPP also mandates that countries should have adequate legal frameworks to protect personal data. And again these are central issues for our discussions today as to what kinds of economy we're going towards and what kind of social protections should be embedded given the disruptive effect of technology.

DOLLAR: Right, so listening to you, Mireya, TPP is taking up issues like intellectual property rights protection, data, e-commerce, state enterprises, all these are the modern issues of the reality of international trade in the 21st century. So I guess a question occurs to me is, why isn't the World Trade Organization taking up these issues and putting this kind of agreement into place? What are the obstacles to having a bigger agreement that would involve everybody or almost everybody?

SOLÍS: Well, I think that the major problem with the WTO is that it has stopped functioning as a negotiation forum. Very important to keep in mind, David, is that the WTO has not really wrapped any multilateral round of trade negotiations since its creation more than 20 years ago. And one of the issues is, of course, that the organization is very large—160 members or so—and it works with the consensus rule. And that makes it very difficult. Even the TPP, you're talking about 12 then 11 countries, very importantly these are countries at different levels of development. I think that's another element where the promise of the TPP is clear, that you can have very different, heterogeneous group of countries agreeing to these rules. But then go from 11 to 164 and the chances of striking an agreement are very hard. And then there are baggage issues, and by these I mean that many developing countries in the WTO feel that you have to address first the issues that were not resolved in the Doha Round, and they feel that they make a lot of commitments

as part of the Uruguay Round negotiations and that Doha was going to address some of their concerns and that that has not happened. So in essence the WTP, the multilateral body, has not updated these rules. Seems very difficult when think about all of these issues, David. You talk about modernization, yes. But there are also behind the border issues and they're harder to negotiate and agree to. And I think that the consensus rule and the very large membership of the WTO are very significant obstacles.

DOLLAR: Now, President Trump has made some noise about negotiating a bilateral trade agreement with Japan. So I'd like to ask you about that. What are the prospects? Is that likely to be just a copy of TPP? Which would leave the question, why did the U.S. pull out?, since the U.S. and Japan are overwhelmingly largest economies in that original group of negotiators. Or is the U.S. looking for something partial, something specific? How do you see the U.S. Japan trade relations developing?

SOLÍS: It's going to be something old and something new. Japan wanted and still wants the United States to return to TPP. Japan feels that that's the best framework, that the world economy is multilateral, and that a lot of the benefits of the TPP really come from bringing together different economies and pooling the different comparative advantage of all these economies.

But, you know, the United States has taken a very different direction on trade policy under the Trump administration. And one of the issues that the Trump administration has done is use what we call Section 232, which uses national security as a consideration for raising tariffs on specific sectors. And these already took place in steel and aluminum, and the Japanese and other countries were targeted.

But there's an ongoing investigation, David, on automobiles and the economic stakes are much higher. Automobiles is at the center of the U.S. Japan economic relationship both in trade flows and investment. And the United States and Japan, similar to what happened with the E.U., agreed to a ceasefire. And that is in a sense they agreed

let's negotiate, let's discuss, and while we negotiate the United States has agreed not to impose any 232 automobiles. The report is not yet out, it'll be out in February and we'll see what happens. But as long as there's good faith negotiations the Americans have said that they will not impose these tariffs.

I bring these background, David, because I think it's important to understand that this is not Japan's first choice to talk about a bilateral trade agreement. So you begin to see that differences in opinion and in positioning.

There is also disagreement on the scope of the negotiations. And this is reflected in the acronyms, the different acronyms that both sides are using. This might sound like a very nerdy discussion but in fact it's important. The United States has been saying we want a full-fledged free trade agreement. Japan is saying no. We're talking about a narrower negotiation and they have the acronym of TAG, a trade agreement on goods. So they want to have a fast negotiation that focuses, say, on agriculture and tariffs and automobiles goods.

But they do not want to talk about the rules because they believe that that creates an incentive for the United States to consider still the benefits of the TPP, but also because they don't like some of the new rules that the Trump administration is putting on the table. Two that I would highlight that I think are going to be the most difficult obstacles in these talks, is currency manipulation in their revised NAFTA agreement. You have now a currency manipulation clause in the body of the text. This is now known as a U.S.-Mexico-Canada trade agreement. It is the position of Japan, a longstanding position, that you do not mix currency and trade policy issues. So they don't want to see that development.

And another very important issue, David, is that the Trump administration is likely to demand from Japan some kind of export restraint on automobiles. This is a nightmare scenario for Japan. Japan has bitter memories of this type of negotiation going back to the

1980s, 1990s. They feel they overcame managed trade. They don't want to go back.

DOLLAR: Right. If you look at the U.S. negotiation with Mexico in the context of reforming NAFTA, on the one hand the U.S. brought some whole chapters from TPP which again left many economists wondering why did the U.S. leave if it's bringing the whole chapter on IP and chapter on state enterprises. The labor chapter is actually interesting. It's going to require Mexico to change its legislation to make it easier to organize unions and have collective bargaining.

But separate from TPP the U.S. brought in two very important things into that Mexico agreement. One is essentially domestic content requirement in the auto industry which they slipped in, and the other is the currency chapter that you mention. Not particularly controversial from Mexico and Canada. They have freely floating exchange rates but it's a template for what the United States might want to do. So that really was the logic of the U.S. pulling out of TPP was to then take on countries one by one all of whom are much smaller than the United States. So yes. So make sense for Japan to be a little bit worried about that.

SOLÍS: Yes. So I think that, you know, there are different scenarios. One is the USTR, the U.S. trade representative, has said we want to approach this negotiation in stages and going back to a point we discussed earlier, David, because they feel the pressure on agriculture because of the CP-TPP entering into force at the end of the month, they want to have something that they can give to American farmers very quickly. And, you know, maybe Japan is willing to go along with that provided, and this was also something that was negotiated in the joint statement, provided the United States does not ask for more than what Japan agreed to in terms of agricultural liberalization in TPP. And it going back to an earlier point, Japan the country that opened at least the agricultural market.

So, you know, negotiations take a life of their own and I'm sure that many agricultural groups in the United States may want to get more. But if the United States puts

that request on the table that will also complicate the talks.

DOLLAR: Right. It seems like it would be a smart strategy for Japan to agree to more or less the same agricultural regime that's in TPP, agree with the U.S. on that, move quickly on that, but then stall further negotiations and developments.

SOLÍS: I think so. I believe that's probably what they'll do.

DOLLAR: Okay, last topic I want to take up, Mireya, is new members to this group. So how does that expand beyond 11? What are the prospects? What has to be done and what do you think is likely to happen?

SOLÍS: Another very interesting thing about the TPP is that it does not really have geographical restrictions. When you think about preferential trade agreements, David, you're usually thinking about regional trade agreements and therefore you team up with people in your neighborhood so to speak. But, you know, the TPP from the get go it's Asia-Pacific broadly speaking so you have Asian countries, you have countries in North America, and you have countries in South America. And the idea is that as long as you want to live by the TPP standards then in principle you can request accession. And the TPP countries already have been discussing how are we going to move and bring new members. I imagine that the process will work along the lines of, I believe the rules are fixed. You don't get to, you know, ask to be admitted into the club and change the rules. But what you will negotiate is the market access part. That is, how fast you eliminate your tariffs. And this was done in the TPP bilaterally so that would mean that every new entrant will have to approach all existing members and negotiate on the calendar for tariff elimination.

There are several countries that have already expressed strong interest. One of them is Thailand, and the other one is Colombia. But other countries that could eventually also make their way to the TPP are South Korea. And, you know, the prime minister of Japan has extended a warm invitation to the UK as well. That's not going to happen right

away because first they have to figure out what's happening with Brexit and if they leave under what terms and so forth. But I think it's interesting point of information in the sense that countries who want to hedge against the rise of protectionism, countries who want to diversify, countries who still believe in this rules-based international order it could find a home in the TPP. And therefore that would mean that they would be has yet many more lives to live.

DOLLAR: I think the president of Indonesia has also expressed an interest. If you got Indonesia and South Korea in TPP you would have five of the 15 biggest economies in the world. So it has the potential to really become a very, very significant foundation for trade in the Asia-Pacific.

SOLÍS: Agreed. And the other issue is one of readiness and where these countries want to work towards these standards, because these are very ambitious levels of liberalization and the rules as we mentioned before are very comprehensive. So there are many countries that are already doing the gap analysis and trying to determine what would I need to do to be able to join TPP. And then every country has a political decision to make and the messy consultation to carry out.

DOLLAR: Well thank you very much, Mireya, for educating us about the Trans-Pacific Partnership and what's going to go into effect on December 30th, 2018. Thank you very much.

SOLÍS: Thank you. It's been great fun. Thanks.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of "Dollars and Sense" every other week. So if you haven't already, make sure to subscribe on Apple Podcasts or wherever else you get your podcasts and stay tuned.

In our next episode we're going to look at trade and U.S. manufacturing. And my guests will be Brad Setser from the Council on Foreign Relations and a well-known economist writing about trade and manufacturing.

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