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## The Trans-Pacific Partnership: Overall economic impact, and what it might mean for U.S. agriculture

### Background

The Trans-Pacific Trade Partnership (TPP) agreement, signed in early-October 2015, is the largest regional free trade agreement (FTA) struck in the past two decades, and along with the Transatlantic Trade and Investment Partnership (TTIP) being negotiated between the US and European Union (EU), it represents an important new direction in trade liberalization. After seven years of negotiations, 12 countries agreed to the terms of TPP. While each member country now needs to ratify the agreement for it to be put into effect, TPP could significantly boost the export market potential for American farmers, as well as other sectors of the U.S. economy.

The partnership includes 12 countries which in 2014 accounted for approximately 36 percent of the world's economy, and 23 percent of world trade: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the U.S. TPP is anticipated to reduce more than 18,000 tariffs, including many agricultural trade barriers. In 2014, the 11 other members of TPP, accounted for \$1,567 billion worth of U.S. exports, with Canada, Japan and Mexico accounting for 89 percent of the total.

TPP, and other "mega"-trade deals such as TTIP have emerged amidst uncertainty about the global trading system and the future of the World Trade Organization (WTO). Starting in the early-2000s, the rate of growth of global trade slowed relative to GDP growth, and since

the "great recession" trade is not driving growth of either industrialized or emerging economies (Hoekman, 2015). Also, despite limited progress in the WTO with agreements to simplify customs rules and eliminate agricultural export subsidies being signed in December of 2013 and 2015 respectively, the Doha Round of multilateral trade negotiations, initiated in 2001, have yet to be completed. At the same time, there has been a significant increase in the number of regional/bilateral FTAs globally, with over 300 currently in force and notified to the WTO. The U.S. itself already has FTAs in force with 20 countries, and there are already 39 FTAs in existence affecting the Asia-Pacific region, with others being negotiated.

This shift in focus to regional trade liberalization has been driven by several factors. First, compared to the period between formation of the GATT in 1947 and completion of the Uruguay Round of trade negotiations in 1994, the world economy has become multi-polar, moving from one dominated by a "coalition of the willing" (the US, EU, Japan and Canada) able to promote multilateralism within the GATT/WTO (Collier, 2006), to one where emerging economies such as Brazil, Russia, India, China and South Africa (BRICS) are now more able to influence and re-arrange the global trading system. Second, trade linkages have become much more complex with disintegration of the vertical production chain and the associated increase in offshoring of production of

intermediates by developed to developing countries (Baldwin, 2016). A new type of international commerce has evolved that used to occur within firms or between firms in developed countries, e.g., investment and supply of know-how. As a consequence, developed countries are more interested in trade rules that protect investment and intellectual property than they are in tariffs. Third, most orthodox trade barriers have already been eliminated through eight successive rounds of the GATT, such that average *ad valorem* manufacturing tariffs have fallen from over 40 to less than 4 percent. In addition, despite the lack of any substantive progress in the Doha Round, the rise of offshoring has resulted in unilateral cutting of tariffs by developing countries seeking to become part of international production networks (Baldwin, 2016).

Due to these changes in the trading landscape, it is widely argued that trade liberalization has shifted from the “shallow” integration of the GATT/WTO, characterized by tariff-cutting, to one of “deep” integration, where the focus is on legally-binding provisions that go well beyond tariff-cutting. The expectation is that deeper economic integration among countries will require incremental steps among a close group of close partners negotiating on a specific set of provisions, in order to simplify negotiations, reduce adjustment costs and mitigate any political opposition (Petri, Plummer and Zhai, 2011).

The origins of TPP can be seen as development of a framework for guiding further economic integration in the Asia-Pacific region, given the rapid growth of bilateral and regional FTAs affecting countries in the region since 2000. From the standpoint of the U.S., TPP serves four important goals: first, it represents a “gold standard” for future trade agreements involving the U.S., i.e., it covers dimensions such as trade in services and foreign direct investment (FDI) that are not part of the Doha Round; second, TPP may pave the way for broader economic integration in the Asia-Pacific region with the potential of generating much greater economic benefits than a typical, narrowly-defined FTA; third, TPP could provide a model for taming the Asia-Pacific “noodle bowl” of overlapping FTAs in the region, where complex rules of origin (ROOs) can result in

economic inefficiency; and, fourth, the U.S. will get preferential access to some Asian markets covered by existing FTAs such as ASEAN, and of which it is not a member.

## **Expected Economic Benefits of TPP**

### *Income Gains*

While full details of TPP have only recently been made public, substantial economic growth is expected under this FTA. Petri and Plummer (2016) estimate that under TPP, \$492 billion will be added to global GDP by 2030, including a \$131 billion increase (0.5 percent) in U.S. GDP and a \$125 billion (2.5 percent) in Japanese GDP. There will also be a significant growth impact for some of the emerging economies included in TPP. For example, Vietnam and Malaysia are anticipated to experience 8.1 and 7.6 percent increases respectively in their GDP, amounting to \$41 and \$52 billion. In particular, Vietnam, a low labor cost economy, is expected to expand as a manufacturing hub in industries such as textiles and apparel. These gains in GDP reflect benefits from both increased trade as well as FDI, with a large part of the gains to the U.S. likely to come from trade in services and FDI in the service sector.

### *Tariff-Cutting*

While there is currently a low trade-weighted,<sup>1</sup> average tariff rate of 2.6 percent applied by TPP members against other TPP members, there is quite a bit of variation across TPP members, leaving room for substantial trade liberalization (Freund, Moran and Oliver, 2016). Average trade-weighted applied tariffs vary from 0.4 percent in Singapore to 6.2 percent in Vietnam. The U.S. applies, an average tariff of 1.2 percent against other TPP members, with its highest applied tariff being 4.4 percent against Vietnam. In terms of actual tariff-cutting, upon implementation of TPP almost 75 percent of all tariffs will be removed, and in the long-run, 99 percent of trade in goods will be liberalized. With respect to the timeline and specific products, almost all tariffs, including the 350 percent tariff on U.S. tobacco and tobacco products will be zeroed out by year 16 of TPP being in force.

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<sup>1</sup> The average of a country’s tariffs weighted by the value of its imports.

After year 16, only U.S. tariffs on imports of Japanese cars and trucks, at 2.5 and 25 percent respectively, will remain in place after year 30 of the agreement.

### *Trade and Investment Effects*

Petri and Plummer (2016) estimate that exports among all TPP countries will grow \$1,025 billion by 2030, an increase of 11.5 percent. The lion's share of export growth will be captured by the U.S., Japan, Vietnam and Malaysia, their exports increasing by \$357 (9 percent), \$276 (23 percent), \$107 (30 percent) and \$99 (20 percent) billion respectively. For the U.S., export gains will occur in the primary good (agriculture and mining), advanced manufacturing and service sectors, with increased imports in labor-intensive sectors such as textiles and apparel. At the same time, the potential for trade diversion, where trade between TPP members displaces trade with non-TPP members, while tangible for countries such as China, India, Korea and Thailand, will be small relative to those countries' GDP.

In terms of FDI, Petri and Plummer (2016) expect that by 2030, inbound FDI will increase \$446 billion (4.5 percent) compared to an increase in outbound FDI of \$305 billion (2 percent). The largest recipients of inbound FDI will be the U.S., Canada, Japan and Malaysia, and the largest sources of outbound FDI will be the U.S., Japan and the EU. Inbound FDI exceeds outbound FDI due to the improved investment environment within TPP.

### *Sectoral Effects*

The sectoral effects of TPP need to be placed in the overall context of the structure of the U.S. economy. As of 2014, the U.S. manufacturing sector accounted for 12 percent of GDP, and only 9 percent of employment – down from 13 and 11 percent respectively in 2004, a decline expected to continue irrespective of U.S. trade policy. Given that the U.S. economy is unambiguously a service-oriented economy, it is perhaps not surprising that the expected positive impact of TPP on trade is concentrated in that sector, along with advanced manufacturing and agriculture, where the U.S. has clear comparative advantage.

Currently, the U.S. tradeable business services sector, which includes consulting services, R&D, healthcare, and education services, accounts for 25 percent of U.S. employment, and the sector enjoyed a trade surplus in cross-border transactions of \$233 billion in 2014 (Hufbauer, 2016). The U.S. comparative advantage in services is based on three factors: the presence of large efficient firms, highly educated personnel, and extensive use of information technology. At present the sector faces high barriers to cross-border trade with other TPP members, Fontagné, Guillen and Mitaritonna (2011) estimating overall ad valorem equivalents on service imports to range from 20 percent in Singapore to 73 percent in Mexico. Under TPP, member countries have committed to significantly reducing these trade barriers, with U.S. service exports expected to increase \$149 billion by 2030, accounting for 67 percent of increased TPP trade in services (Hufbauer, 2016).

In the current political climate, trade has been singled out as the main culprit for loss of U.S. manufacturing jobs. At the same time, recent studies by Acemoglu et al. (2014) and Autor et al. (2013) suggest import competition from China over the past decade has had a significant effect on the number of manufacturing job losses as well as a negative impact on local job markets. It is not surprising therefore that TPP has been attacked by politicians from both sides of the aisle as they tap into deep public concern about the effects of globalization.

However, the expectation is that TPP will not have a very large impact on U.S. employment. As resources continue to shift from basic manufacturing to traded services and advanced manufacturing, TPP is likely to favor skilled labor in the U.S., given that the service sector is skilled-labor intensive and basic manufacturing is capital/low-skilled labor intensive. While returns to all inputs will increase due to productivity gains, wages will increase by more than returns to capital, and wages of skilled workers will increase more than those of unskilled workers.

In terms of employment, Petri and Plummer (2016) estimate that 72,000 jobs/year will be "shifted" over the period 2018-28 due to TPP, where job shifts account for inter-sectoral

changes in jobs, i.e., jobs lost in one sector(s) relative to jobs gained in another sector(s). If these job shifts/year are reduced by 25 percent, the number of jobs shifted due to voluntary and other separations, 54,000 annual job changes in the U.S. will be involuntary and attributable to TPP. Placing this in perspective, 55 million jobs are “churned” a year in the U.S., TPP accounting for less than a 0.1 percent increase in the rate of churn.

Nevertheless, while some workers displaced by TPP will get reemployed, others will find it either harder due to age and location, and/or they will end up getting jobs paying lower wages. As a consequence, many economists (Lawrence and Moran, 2016), as well as commentators in the media (*The Economist*, 2016; *New York Times*, 2016; and Krugman, 2016) are suggesting that the U.S. should target strategies to support workers who bear the cost of trade liberalization, including upgrading skills through vocational training, helping workers find new jobs via job exchanges and relocation grants, and developing a system of wage insurance to protect workers against income loss. In other words, the objective is to get the winners from trade to compensate those that lose.

### **TPP and Agriculture**

Over the period 2010-12, agricultural imports by TPP members totaled \$279 billion. Of which 51 percent were sourced from other TPP partners, while 43 percent of their agricultural exports went to TPP partners. Across TPP members, Canada and Mexico are both highly dependent on other TPP members for both agricultural exports and imports, mostly due to their trade with the U.S. In the case of the U.S. over the same period, 42 and 47 percent of its agricultural exports and imports respectively went to/were sourced from other TPP members (Burfisher et al., 2014).

Agricultural products traded between TPP members are currently subject to higher applied tariffs on average, than manufactured products – 5.2 vs. 1.8 percent - although bilateral protection varies considerably by country (Disdier, Emlinger and Fouré (2015). For example, average applied agricultural tariffs are 3.6 percent at the U.S. border compared to 23 percent at the Japanese

border. Agricultural tariffs also vary based on whether trading partners are members of an existing FTA, and also by product. For example, Mexico’s average applied agricultural tariff against TPP members is 15.6 percent, ranging from 30.7 percent against Australia to 3.2 and 1 percent on agricultural imports from Canada and the U.S., its NAFTA partners. In the case of specific agricultural products, different TPP members currently have high levels of protection for different products. For example, Canada protects its markets for dairy products, poultry and eggs, its average applied tariff on U.S. dairy products being 110 percent, even though Canada and the U.S. are both members of NAFTA. Japan protects its markets for beef rice, wheat, barley, sugar, dairy products, and selected fruit and vegetables, Japanese applied import duties on cereals exceeding 200 percent, largely due to the level of protection afforded to its rice sector. In the case of the U.S., sugar, selected dairy products and tobacco are protected with the applied tariff on tobacco products currently applied at 350 percent (Freund, Moran and Oliver, 2016).

In order to evaluate the extent and potential impact of agricultural trade liberalization under the TPP agreement, it is useful first to report the results of the U.S. Department of Agriculture’s (USDA) Economic Research Service (ERS) study by Burfisher et al. (2014) that estimated the impact of removing all agricultural tariffs and tariff-rate quotas (TRQs) by 2025.<sup>2</sup> All things being equal, this can be considered an upper bound to the likely trade effects of TPP on the agricultural sector. The USDA/ERS estimates indicate that TPP will result in a 6.6 percent increase in agricultural trade by 2025. This increase will account for an additional \$8.5 billion in the agricultural marketplace. TPP will increase U.S. market access to several countries where it currently has no FTA, notably Japan, where 50 percent of U.S. agricultural exports will face zero tariffs once TPP is implemented. In the case of other agricultural products, preferential access will be given under new tariff-rate quotas, where specified levels of imports will be subject to low tariffs, including dairy

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<sup>2</sup> TRQs are a policy instrument whereby a country commits to a minimum amount of imports (quota), subject to an in-quota tariff, while imports over the quota are subject to, a higher over-quota tariff.

products imported by Canada, and rice, wheat and barley imported by Japan. With Japan being its fifth largest agricultural export market, reduction in their agricultural tariffs has been a long-held objective of U.S. trade policy, and one not addressed as yet in the WTO. With increased market access, USDA/ERS anticipates that TPP will result in a 33 percent overall increase in U.S. agricultural exports and a 10 percent increase in imports by 2025. Overall, the U.S. agricultural sector is expected to be a big winner from implementation of TPP, exports to Japan accounting for a large share of these trade gains.

Of course, while TPP will result in considerable liberalization of agricultural trade, the nature of the agreement is that there is a phase-in period across countries and products. Once the agreement takes effect, almost 32 percent of tariff lines in Japan, 31 percent in Vietnam, 92 percent in Malaysia, all but one tariff line in Australia, and 99 percent in New Zealand will be eliminated, with additional liberalization being phased in over 15 to 20 years (Hendrix and Kotschwar, 2016). However, significant barriers to market access will remain in some areas, notably the dairy sector, where the Canada, Japan and the U.S. backed off dairy sector reform in order to maintain domestic support programs.

Looking at the implications of TPP in some specific sectors: (i) in the case of livestock and meat products, Japan, Mexico, Peru and Vietnam committed to substantial or complete phase-out of their tariffs, especially for beef and pork – for example, Japan will reduce its tariff on fresh, chilled and frozen beef from 38 to 9 percent within 16 years, and it will phase-out its tariffs on pork products within 10 years; (ii) for rice, Japan has made very modest concessions, despite significant pressure from both Australia and the U.S. for expansion of market access, raising the country-specific annual import quotas (CSQs) by 6,000 and 50,000 metric tons respectively, with expansion to 8,400 and 70,000 metric tons respectively within 13 years; (iii) with respect to sugar, the TPP negotiations reflected the fact that there are only three significant players among the member countries, the U.S., Mexico, and Australia. The latter will see a 60 percent increase, 65,000 metric tons, in the amount of sugar it

is allowed to export annually to the U.S. This is significantly less than what Australia sought in the negotiations, and in terms of U.S. market access, places it well behind Mexico's annual exports of 1.0 to 1.5 million metric tons, Mexico having become the residual supplier to the U.S. due to NAFTA; (iv) finally, in the case of dairy products Japan did make some commitments to relax border protection, although it will continue to maintain limited market access through TRQs for butter and milk – for example, its import tariffs on cheese, which range up to 40 percent, will be eliminated within 16 years. By contrast, Canada made very few changes to its dairy trade regime.

## **Conclusion**

Signing of the TPP has the potential to have important economic effects on its member countries in terms of growth in GDP, trade and cross-border investment flows. However, its real significance may lie beyond its initial impact due to the fact that it is pioneering a new type of free trade agreement that goes beyond shallow integration via tariff-cutting to one addressing deep integration in terms of its provisions concerning trade in services, foreign direct investment, rules on competition and regulatory harmonization. In particular, TPP has the potential to deliver additional economic benefits in the long run if it provides a means to eventually untangling the Asia-Pacific "noodle bowl" of multiple free trade agreements with their complex rules of origin, and sets the ground rules for further economic integration of the region with China.

In the case of agricultural trade, the U.S. is expected to be a big winner through tariff cuts under TPP, increased access to the Japanese market accounting for a large share of these gains.

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### Questions or comments?

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