CARLO ALLEGRI / REUTERS

*Shoppers ar...*

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# Trade Trials

## Getting TPP Right Is Better than Getting It Fast

*By Richard Katz*

benign world hegemon will be diminished.

To avoid this, the White House is determined to get the pact signed and ratified this year. Otherwise, campaigning for the 2016 elections will put off a congressional ratification vote until at least 2017, five years after the original target date of 2012. Meeting the 2015 goal will be an uphill climb. That's because it takes up to six months to translate a trade pact into the legal language of domestic legislation. To get a ratification vote this year, the White House would have to persuade both the U.S. Congress to approve Trade Promotion Authority (TPA) in May or early June and its 11 TPP negotiating partners to sign a deal by June or July. The partners have made it clear that they won't conclude the negotiations until Congress approves TPA for U.S. President Barack Obama, which would give him the authority to call a yes/no vote on TPP in Congress with no amendments. The TPP nations have no reason to present their best offers if they fear that the U.S. Congress will be able to treat their concessions as a floor, not a ceiling. The May 11 Senate vote against proceeding to an immediate debate on TPA means that the Senate probably will not even vote on TPA until June, and it remains unclear whether TPA can pass the U.S. House of Representatives.

TPP proponents condemn the partnership's opponents in Congress or other countries for the delay and argue that holding back TPP until 2017 risks turning the negotiations into another Doha trade round (which began in 2001). However, blame lies not just with other TPP countries and domestic opponents. It also lies with the posture taken by TPP's proponents in both the U.S. government and the business sector. In that light, a delay could be worth the risk if it results in a better TPP.

## THE REAL BENEFITS OF TPP

A major part of the United States' role as benign hegemon was to support free trade. The lesson of World War II was that the United States is better off if other countries are more prosperous. Although prosperity does not guarantee a more stable, peaceful, and democratic world, it does help the world move in that direction. And expanded trade not only allows countries to become more prosperous faster, it also increases their stake in the well-being of their neighbors.

For example, small territorial wars in offshore Asia (such as the Indonesia-Malaysia conflict in the early 1960s) have become a thing of the past as political leaders gained support by making their nations rich via export-led growth. Despite the harsh rhetoric flying between Tokyo and Seoul over tiny islets, they will not go to war. The major exception is, China's abrasive pursuit of territorial ambitions in the western Pacific, which poses the risk of conflict. Still, the country is far less dangerous internationally than it was under Mao Zedong. Much of that political evolution has occurred because China's leaders know that the rapid growth undergirding their rule depends on economic interdependence. Over the long run, bringing China into TPP would further the trend, hopefully

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strengthening those inside China who want to liberalize the economy and make the country a more responsible stakeholder in the world. From this standpoint, Washington's attempt to dissuade its allies from joining the China-initiated Asian Infrastructure Investment Bank (AIIB) was as unwise as it was futile.

For its part, the United States is already so open to trade that most of the direct economic gains from any new free trade agreements will go to its partners. According to the "bible" of TPP proponents, *The Trans-Pacific Partnership and Asia-Pacific Integration,* which was published by the Peterson Institute for International Economics in 2012, U.S. national income in 2025 would be just 0.4 percent higher with TPP than without it. Meanwhile, for Japan it would be 2.2 percent higher, for Malaysia 6.6 percent, and for Vietnam 14 percent. For example, if Japan further opened its farm sectors, American exporters would gain sales, but Japan's overall economy would gain far more than that of the United States. That's because Japanese consumers have to spend 14 percent of their household budget on food, compared with six percent for Americans and nine percent for those in the United Kingdom. Lowering food prices would liberate a lot of consumer purchasing power.


*A protester wearing a monkey mask raises his fist during a rally aga...*

*The Trans-Pacific Partnership and Asia-Pacific Integration* probably underestimates the benefits to the United States and others because it omits certain hard-to-measure ongoing productivity gains. For example, much of the productivity revolution in the United States that began in the late 1990s came about because heightened international competition impelled firms to finally adopt long-needed improvements in technology and corporate organization. Beyond that, the United States stands to reap geopolitical gains through TPP by fostering a community of nations that requires smaller U.S. military expenditures to maintain regional security and that are more willing to cooperate with Washington because they see the United States, on the whole, as a more benign force than any alternative.

The United States' political hurdle is that the post–World War II domestic bipartisan consensus supporting free trade has all but disappeared. That's because most of the fruits of American growth in the past few decades have gone to a tiny percent of the population; two-thirds of national income gains went to the top one percent of the population between 2000 and 2007, and even more during the post-2009 recovery. Labor unions have blamed international trade, but the reality is that trade explains only ten to 20 percent of worsening inequality. More impactful is a political system that has eroded the minimum wage, walked back progressive taxes, diminished labor unions, cut budgets for public schools and student aid for college, and so on. (But some of the union complaints are understandable: according to a 2005 Organization for Economic Cooperation and Development [OECD] study, when U.S. workers lost their jobs because of imports, their next job paid 20 percent less, the worst performance of any rich country.

In the absence of broad support for free trade, U.S. trade negotiators are often forced to placate narrow corporate interests in order to cobble together the razor-thin majority needed to get congressional ratification. And many shortsighted business groups unintentionally aid the antitrade forces by resisting even such woefully insufficient compensatory measures as Trade Adjustment Assistance (TAA), which offers financial help for some workers directly hurt by imports. Critics thus see negotiators as acting more like lawyers for special interests than champions of the national interest.

## BAD POLITICS

The new politics of trade has led the United States toward some self-defeating negotiating tactics. A prime example is its insistence that TPP talks not be guided by the most-favored-nation (MFN) principle that is at the heart of the postwar free trade order. MFN means that any concession that, say, the United States or Japan makes to each other must also be extended to every other participant in the trade agreement. Without MFN, any tariff reductions that Japan grants for U.S. beef or pork exports would not have to be automatically extended to American ranchers' competitors in Australia or Canada.

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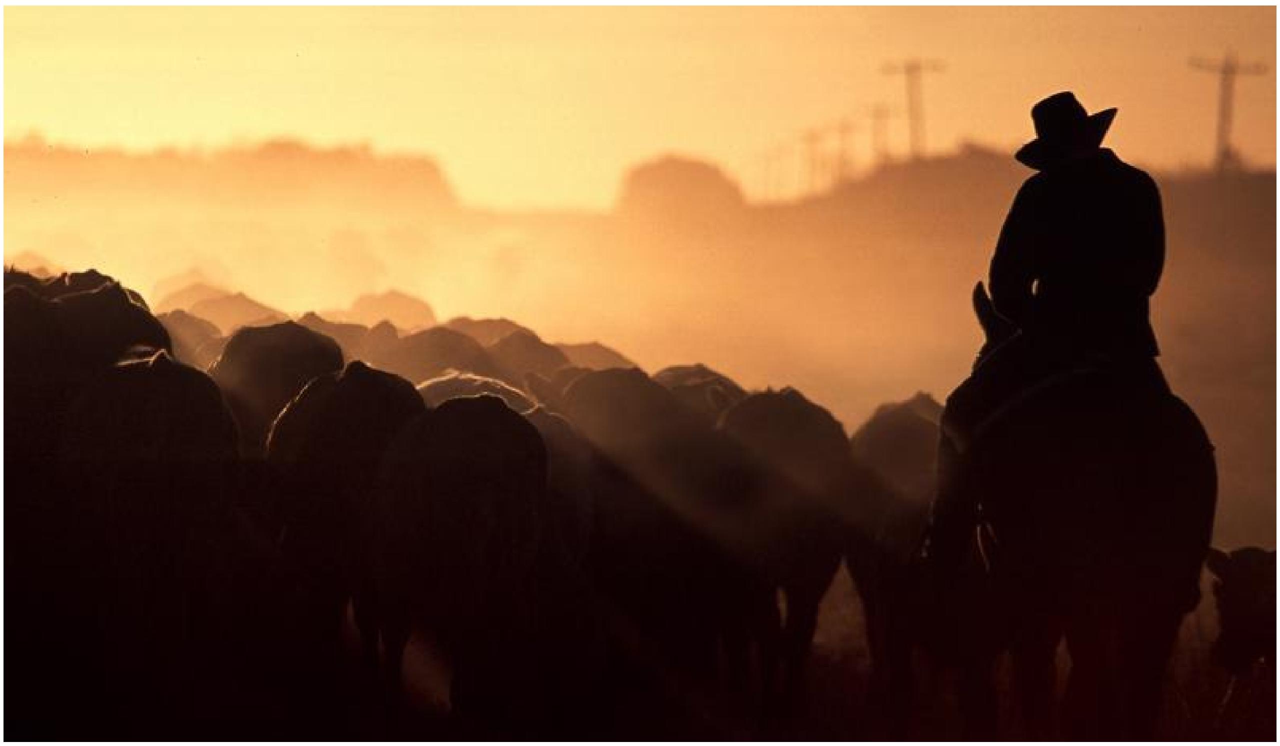
This may sound as if it gives U.S. exporters a leg up. In reality, without MFN, no other TPP country has a direct stake in U.S. success with Japan on import liberalization, and that has reduced U.S. leverage with Tokyo. Indeed, the entire TPP negotiation has been held up because the United States and Japan have spent so much time haggling over economically trivial but politically important issues. These include Japanese barriers to imports of beef, pork, and the like (the production of which involves fewer than 100,000 of Japan's 46 million households). It also includes how long the United States will take to eliminate tariffs on Japanese auto parts that, on average, add six percent to the price of the parts (far less than the yen's 30 percent depreciation over the past couple of years). The other ten TPP countries have delayed the resolution of myriad issues that hinge on the U.S.-Japanese outcome. For example, a country like New Zealand might give more to Washington on some regulatory issues if it can export more dairy products to Japan.



*A farmer rides his horse as he herds his cattle towards stockyards ne…*

Another egregious example is the investor-state dispute settlement (ISDS) system, which is contained in a number of trade treaties, including the draft TPP. Under ISDS, corporations can sue governments for "loss of anticipated profits" due to new regulations. The dispute is settled neither in domestic courts nor by the World Trade Organization (WTO), but in special arbitration panels from which there is no appeal. According to a 2012 OECD study entitled *Investor-State Dispute*

*Settlement,* half of all ISDS arbitrators serve as lawyers for corporations in other ISDS cases, whereas only ten percent have represented governments being sued. With companies paying an average of $8 million per case, an ISDS arbitrator, unlike a court judge or a WTO panelist, has a direct financial incentive to see more merit in the corporations' arguments.

Originally, ISDS was put in place to make sure that firms got properly compensated when their property was expropriated by some dictator who could manipulate his country's courts. Today, it's very different. R.J. Reynolds, for example, threatened to use ISDS to sue Canada on the grounds that a regulation compelling the firm to use plain wrapping on cigarettes was akin to expropriation. Canada backed down on the regulation. Philip Morris has a similar case against Australia. Eighty-five percent of the cases launched by American firms against foreign governments have involved regulatory, environmental, and natural resource issues. Senate Majority Leader Mitch McConnell (R-Ky.) has since threatened to block the entire TPP if the White House accedes to requests from some other TPP countries to exempt tobacco from ISDS procedures. And now, reports the OECD, hedge funds, banks, and other entities are fostering a new wave of ISDS cases by financing suits in return for getting 20–50 percent of corporate winnings, a practice that is illegal in most domestic courts of OECD countries.

Some TPP and EU countries (in separate U.S.-EU trade talks) want to modify or eliminate the entire ISDS provision because of its chilling effect on a country's ability to regulate. The simplest remedy would be to replace ISDS with WTO dispute settlement mechanisms. But, presumably at the behest of U.S. firms the

White House needs to lobby for TPP, the administration is adamant about keeping ISDS as is.

## GRAND BARGAIN

It is the thinness of the pro-trade majority in Congress that gives each narrow group the power to tip the balance. That, in turn, lessens Washington's ability to serve the national interest and increases the perception among the United States' trading allies that the country is less a benign hegemon than a selfish one.

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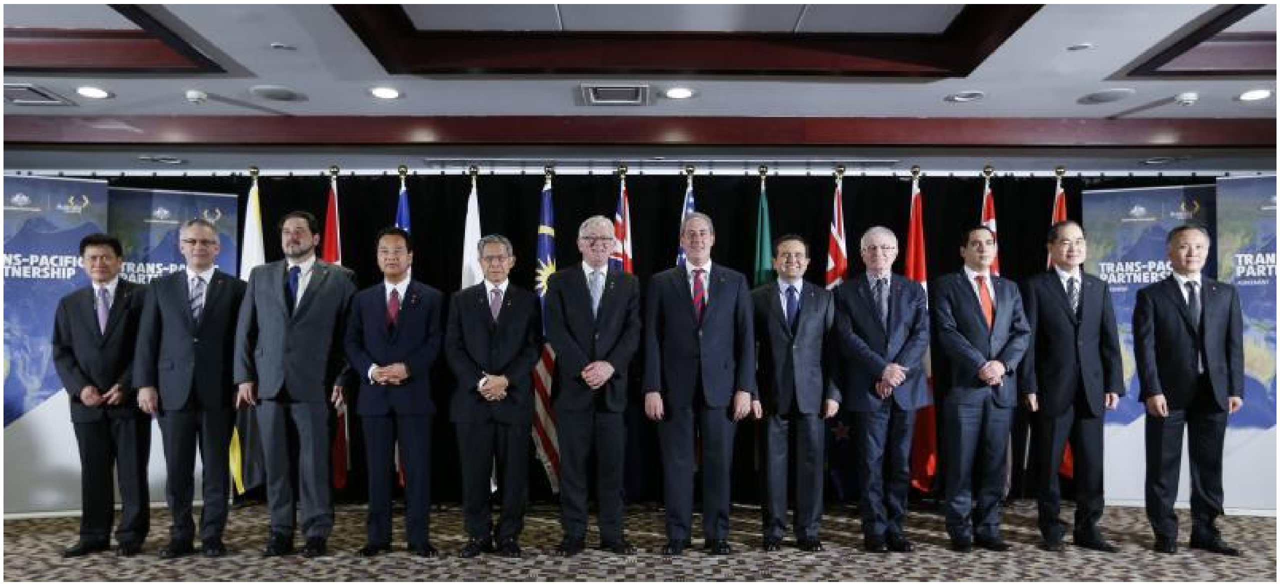
To restore bipartisan support for free trade, and thus lessen special interest leverage, it is necessary to turn to the proposal of nineteenth-century classical economist John Stuart Mill for "free trade plus compensation." Although free trade is a win-win proposition for each nation as a whole, within each nation, trade makes some citizens richer and others poorer. Fortunately, the gains for the winners are so big that some of them can be redistributed so that every citizen is better off. Unfortunately, these days almost all of the twentieth-century measures used in the United States to promote income equality and security—from a progressive income tax, to a minimum wage that keeps up with inflation, to Social Security, to the very existence of labor unions, to publicly funded education—are under attack. Trade is unjustifiably scapegoated for the consequences of this whole ecosystem of policies.

Some countries, such as France, the Netherlands, and Sweden, make sure that trade, technological progress, and wages all rise in tandem by spending as much as one to two percent of GDP on "active labor measures." These include retraining services and active efforts to help find new jobs for those displaced by trade or domestic changes in technology. The United States, by contrast, spends the least among rich countries, just 0.1 percent of GDP. This is penny wise and pound foolish for U.S. growth, living standards, and the politics of trade.

Of course, U.S. politics is not the only reason TPP is in danger. Japan has prolonged the entire TPP process by being incredibly stubborn on farm liberalization, to the detriment of its own economy. While it is reducing many barriers, it also looks as though it will succeed in exempting more products from complete tariff elimination than has occurred in all other American free trade pacts since the North American Free Trade Agreement (NAFTA)—combined. Some developing nations have sought to protect state-owned enterprises. It's much harder to persuade other governments to challenge their own domestic special interests, though, when the United States' negotiators seem unwilling to do the same.




*Trade representatives from 12 nations gather for a group photo duri...*

Business and its political allies that want free trade must recognize the need for a grand bargain—free trade plus compensation—along a whole range of axes. Until the United States restores bipartisan support for free trade, the White House will not only have trouble getting Congress to approve new free trade agreements, it will have trouble getting increasing numbers of would-be partners to agree as well. At the same time, labor unions and their Democratic Party allies need to recognize that TPP or no TPP, globalization is going to continue. Rather than fight the inevitable, they, too, should focus on the grand bargain.

Security experts who want other countries to support U.S. leadership have to ensure that, when it comes to trade pacts, American hegemony remains benign. The more that U.S. negotiators are compelled to coddle special interests at home, the fewer friends and allies the country will have on all sorts of issues, including the very complex one of how to integrate a rising China.

Finally, the White House should reconsider its stance that TPP must be ratified this year at all costs. Given that TPP will be the template for trade rules for years and years to come; that members hope to expand it to dozens of nations, including China; and that Washington needs to restore bipartisan support for free trade, getting TPP right is better than getting it fast. Delay does pose a risk, but both NAFTA and the U.S.-Korea (KORUS) pact were ratified by the successors to the presidents who negotiated them. Obama knows this; he was the one who got Congress to ratify George W. Bush's KORUS pact.