The Economic and Geopolitical Impact of the Trans-Pacific Trade Agreement

Introduction

Winners, losers and many still unanswered questions - the heated public debate goes on - but there can be no denying that the Trans-Pacific Partnership (TPP) has now moved a big step closer to becoming a reality. An agreement has been reached that will likely be ratified and thus usher in what would be the largest regional trade pact in history. The TPP would include 12 countries that together have an annual GDP of almost $28 trillion, accounting for about 40% of the world's GDP and one-third of its trade.


The most significant economic and geopolitical consequences of this potential deal are as follows:

- It represents one of the last opportunities for the United States (and to a lesser extent Japan) to set the standards for a large percentage of the world’s commerce unimpeded by rising powers such as China.

- Notwithstanding certain political rhetoric, given Canada's small internal market, it has little choice but to approve this agreement in order to ensure it is on a level playing field with other countries for access to critical global export markets.

- The challenges facing Canada’s auto and manufacturing sectors predate the TPP negotiations, and will likely intensify going forward.

- Low labour costs and openness to foreign direct investment (FDI) place Vietnam and Malaysia among the countries best positioned to benefit economically from the TPP.

- Announcing the deal is just the first step. Each country needs to ratify the agreement before it comes into force. But it is crucial to note that the fate of the
TPP rests largely with the U.S. Congress. If the deal is passed in the United States, the approval phase will be a foregone conclusion in most other countries. If it fails to pass the Congress, then it most likely will fall apart.

Although the deal will face a tough fight in Congress, we feel that it will ultimately be approved. As has been the case with most U.S. trade-related votes in the past, the combined support of the majority of Republicans (who tend to be more pro-trade) and a minority of Democrats will be sufficient to win approval.

What differentiates the TPP from past trade deals

In contrast to past trade deals, this deal is about much more than cutting tariffs, which have already been reduced to low levels due to past agreements. The focus is now on reducing local-content rules, which have replaced tariffs as the main obstacle to the free flow of goods across borders. It is also about the writing of rules for everything from international data flows and the protection of intellectual property to the regulation of state-owned companies. More specifically: The Trans-Pacific Partnership would prohibit the participating countries from blocking cross-border transfers of data over the Internet and would severely limit the ability of the countries to pass laws requiring the local storage of data. The countries would also be much more constrained when it comes to favouring their state-owned companies over private sector firms, regardless of their nationality. This agreement also includes a dispute settlement process, which permits out of court arbitration between corporations and foreign governments regarding various regulatory matters.

Why the United States has pushed so hard for this Trans-Pacific Agreement

For the United States, this deal is as much, if not more, about geopolitics than it is about trade. It would allow the United States to take the lead in setting the rules of commerce for about 40% of the global economy (i.e., more free market and less government intervention) without having to negotiate with China. This was underlined by a recent comment by President Obama: “When more than 95 percent of our potential customers live outside our borders, we can’t let countries like China write the rules of the global economy.”

This fear of China’s influence is shared by many of the Asian countries supporting the TPP, and was no doubt one of the driving forces behind the culmination of the trade agreement. They see the TPP as a way to counterbalance China’s rising economic power and its aggressive territorial claims to most of the South China Sea. The thinking is that if the TPP proves successful, China and other countries would be compelled to join later under the standards already in place. America’s sense of urgency over completing the TPP has been heightened by the recent creation of the Asian Infrastructure Investment Bank, a new, China-led multilateral development financial institution.

The American president’s biggest advantage in seeking congressional approval is that the trade agreement will be considered under special fast-track rules, known as Trade Promotion Authority, that were passed last summer. Under these rules, the deal will be subject to a simple up or down vote with no amendments or threat of a filibuster. President Obama has to give 90 days’ notice to Congress that he intends to sign any trade deal, meaning he cannot do so before January at the earliest.

**Canada has little choice but to approve the Tran-Pacific Trade Agreement**

Given Canada’s small internal market, it has little choice but to approve this agreement in order to ensure that it is on a level playing field with nations with which it competes for access to global export markets. Indeed, in the event it chooses not to approve the TPP, it would run the significant risk of having to pay tariffs and/or be barred from entering certain markets that would be much more easily accessible for TPP signatories. All of this means that despite threats by certain politicians to not support the agreement, it is almost certain to get Parliamentary approval.

**The biggest winners in the Canadian context**

The most obvious winners of this agreement are beef, barley, pork and fish exporters who would get much improved access to the markets of Japan, Vietnam and Malaysia. Tariffs on many of these items will be eliminated or sharply reduced – some immediately, and the rest over 10-15 years. To cite two examples: 1) Tariffs on beef exports to Japan will drop to 9% from 39% over the next 15 years. 2) Tariffs on Canadian seafood exports - (15%) Japan, (34%) Vietnam and (5%) New Zealand – would be gone within a decade.

The Mining Association of Canada also strongly approves of the deal. The sector exported $158.6-billion (U.S.) to members of the TPP deal last year. Tariffs on metals and mineral product imports into Vietnam and Malaysia are roughly 40% to 50%. They would be eliminated within a decade. The forest products sectors would have also much better access to global markets.

The Canadian banking sector could also be well positioned to benefit from this trade agreement because under TPP foreign banks would have the right to be treated more like local banks.

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5 “Why the TPP is such a big—and good—deal for Canada,” *Maclean’s*, Oct. 5, 2015
The hardest hit Canadian sectors

While joining the Trans-Pacific Partnership deal will open vast new markets for many Canadian companies, certain sectors will be hard hit, particularly the highly protected dairy and automobile sectors.

The Canadian government has agreed to make limited concessions on its supply-managed dairy and poultry sectors by allowing more duty-free imports of products from TPP countries into Canada. Canada’s dairy farmers will give up 3.25% of their market to imports while chicken and turkey producers will give up 2%. The government has promised to fully compensate Canadian dairy and poultry farmers for potential financial losses suffered from the deal (estimated cost: $4.3 billion). The experience of New Zealand offers a ray of hope for Canada’s dairy industry. New Zealand abandoned the supply management system currently used by Canada over 30 years ago, and today has one of the world’s most competitive dairy industries.

Canada’s beleaguered automobile and industrial sectors

Under the TPP, Canada would also agree to reduce protections for the automobile sector. An automobile would need to contain just 45% local content (i.e., parts made within the TPP zone) to avoid trade restrictions. For auto components, the figure would be 40%. This is down from 62.5% and 60%, respectively, under the North American Free Trade Agreement, which the TPP would replace. The Conservative government has pledged $1 billion to the auto sector to help cope with the changes.

It is important to note that the challenges facing the automobile and industrial sectors long predate the TPP negotiations. These sectors have been hard hit by lower wages in the United States and especially Mexico over the last several years. In 2014, Mexico accounted for 20% of light vehicle production in North America, up from only 3% in 1985. This share is projected to rise to 25% by 2022. In stark contrast, Canada’s share of vehicle production in North America fell to 14% last year, its lowest level since 1987. Since 2001, Canada has lost 20% of its jobs in vehicle assembly and auto parts.

Looking more broadly at manufacturing in general, in 2000, manufacturing accounted for 18% of Canada’s GDP; by 2013 that had dropped to 10%. The eventual elimination of many tariffs and other controls on imports of industrial goods means that Canada’s manufacturing sector will face even more competition going forward.

Countries that are best positioned economically to benefit from the trade agreement

Low cost labour, an openness to foreign investment and strong public support for an entrepreneurial economy put Vietnam among the countries best positioned to benefit from this agreement. The Eurasia Group estimates that the agreement will boost Vietnam’s GDP 11% by 2025.9 *(For further information, please refer to our recent report on Vietnam.)* Another potential winner is Malaysia. Its GDP is projected to be 5% higher with the deal than without.

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Conclusion

In summary, the most important geopolitical and economic impacts of the Trans-Pacific Partnership trade agreement are as follows:

- It offers the United States (and a lesser extent Japan) one of the last chances to shape the rules of commerce for a large part of the global economy without having to negotiate with China. Japan and the United States account for about 80% of TPP’s GDP.10

- The deal will open vast new markets for Canadian companies, but at the same time expose traditionally protected sectors to increased foreign competition, particularly the dairy and auto sectors.

- Notwithstanding certain political rhetoric, Canada’s small internal market means it has little choice but to sign on to the deal to ensure it is on a level playing field with competitors for access to major global markets.

- The biggest winners from the deal in Canada are exporters of beef, seafood, grain and industrial mineral products.

- The challenges facing Canada’s auto and manufacturing sectors predate the TPP negotiations, and will likely intensify going forward.

- Low labour costs and openness to FDI will make countries such as Vietnam among the biggest winners of this trade agreement.

Finally, although the deal will face a tough fight in the U.S. Congress, we feel that it will be approved by Congress. The approval phase will be little more than a formality in the vast majority of the other countries.

10 “TPP cements U.S.-Japan ties; Congress could undo pact,” The Japan Times, Oct. 6, 2015
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