Trans-Pacific Partnership Agreement:
Likely Impact on the U.S. Economy and on Specific Industry Sectors

Inv. No. TPA-105-001

Testimony of the
Coalition for a Prosperous America

Before the US International Trade Commission

The Coalition for a Prosperous America (CPA) appreciates the opportunity to provide testimony to the US International Trade Commission regarding the likely impact of the Trans-Pacific Partnership (TPP) on the US economy. CPA is a national, non-partisan organization focusing upon improving American trade performance, eliminating our persistent trade deficit, and growing domestic supply chains as a means to achieving broadly based prosperity in the US. Our members are organizations, companies and individuals involved in or representing manufacturing, agricultural and worker interests.

1. Summary

CPA requests that the ITC place significantly more emphasis upon overall trade competitiveness as exemplified by the balance of trade in its upcoming report on the TPP. The growth of domestic supply chains - including manufacturing, food and services - overall market share domestically and internationally should be the goal of the TPP and any trade agreement.

We recommend that ITC reduce or end its reliance upon the comparative general equilibrium (CGE) model in projecting the impacts of trade agreements because that model has proven misleading to Congress and the public. The Commission should consider discrepancies between past projections of trade agreement impacts in relation to the actual effects seen in the years following implementation when considering how to model the future impacts of the TPP.

In that regard, the Commission should consider non-tariff factors that impact GDP, job creation and the balance of trade. These factors include currency undervaluation, border tax increases, state-owned enterprise, reduction of uncertainty of future tariff hikes as well as other factors.

CPA is pessimistic that the TPP will have a positive impact on the US economy in light of the issues addressed below.

2. The TPP Countries are Diverse in Type and Potential Impact

The diversity of the TPP economies is significant in terms of size, level of development and economic diversity. The Commission should bear in mind that US trade performance has been poor among larger and more developed economies with which we have trade agreements. For example, trade agreements with Mexico, Canada and South Korea have resulted in large and deepening trade deficits overall. While trade agreements with small, less developed economies have performed better, those gains are quite small.

While the TPP consists of approximately 37% of the global economy, that number is misleading because sixty percent of the GDP of the TPP countries is the US. Another 20% of the GDP of the TPP includes countries with which the US currently has trade agreements with (Canada, Australia, Mexico, Singapore, Chile, Peru). The remaining countries constitute 20% of the GDP of the TPP countries. Specifically, Brunei (.06%), Vietnam (.6%), New Zealand (.7%), Malaysia (1.1%), and Japan (17.7%). Japan is the largest of this latter group. However, the Commission should bear in mind that Japan is a partially closed economy that utilizes some aspects of state capitalism to provide an international competitive advantage to its national champion industries in ways that trade agreements do not address.

3. The ITC Should Focus upon the Balance of Trade and Trade Competitiveness as the Primary Overall National Economic Interest

CPA requests that the Commission focus more upon overall US trade competitiveness rather than tariffs and narrow non-tariff barriers to improve the reliability of its TPP report in relation to past trade agreement reports. Tariffs and sectoral non-tariff barriers can easily be overwhelmed or neutralized by other foreign government fiscal, monetary and policy strategies. The CGE model is, in our view, unreliable because it focuses upon tariffs and select NTBs to the exclusion of those foreign government strategies and policies than can neutralize or reverse any expected benefits that could arise from the elimination of tariff or non-tariff barriers.

In our view, the national economic interest with regard to trade policy and trade agreements is improved US trade competitiveness as exemplified by an improved balance of trade, especially in value added products. However, US trade performance has been poor in the last 40 years of persistent trade deficits. We believe our view is consistent with the ITC's reason for existing.

The Bipartisan Congressional Trade Priorities and Accountability Act of 2015 charged the ITC with submitting:

> to the President and Congress a report assessing the likely impact of the agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the agreement, and the interests of United States consumers.[1]

The purpose of the ITC is, in relevant part, to:

> provide the President, USTR, and Congress with independent analysis, information, and support on matters of tariffs, international trade, and U.S. competitiveness.[2]

The word "competitiveness" is often used loosely, but should be used precisely. One definition of <u>business</u> competitiveness is the:

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[1] Public Law No: 114-26, 129 Stat. 320, sec. 105(c)(2), June 29, 2015.

[2] About the ITC, https://www.usitc.gov/press_room/about_usitc.htm

> Ability of a firm or a nation to offer products and services that meet the quality standards of the local and world markets at prices that are competitive and provide adequate returns on the resources employed or consumed in producing them.[3]

Trade competitiveness is more closely related to the US national interest, and thus should be the focus of the ITC's report on the TPP. Trade competitiveness is:

> the ability of a region to export more in value added terms than it imports when including for "terms of trade" to reflect all government "discounts" and import barriers.[4]

The value added aspect of this test is important. Domestic manufacturing and food supply chains add value to commodity products. Many service industries support, and are a part of, these supply chains. Adding value to products provides many benefits including jobs, product innovation, process innovation, and wealth creation at every level… in addition to increasing the value of exports.

US trade competitiveness has failed this test. US manufacturing in almost all sectors has increasingly been in deficit position, including advanced technology. Our persistent surplus in agriculture has been substantially eroded. Rather than adding value with domestic food and fiber products, we increasingly substitute imports for the domestic product. Thus, we lose the jobs, innovation and wealth creation that would have otherwise resulted if the US enjoyed, at a minimum, a balance of trade.

The Commission should address whether the TPP is likely to improve trade competitiveness and the balance of trade.

4. TPP Econometric Analysis Should Include Non-Tariff Factors

We have alluded to our criticism of the CGE model above as inaccurate. A major reason for the inaccuracy is that the model isolates tariffs and select NTB's as the only causal factors impacting future trade flows, holding all other factors constant. The CGE test is, in our view, impracticable, misleading and unrealistic.

Other macroeconomic, fiscal and policy changes often eliminate any expected benefits arising from tariff and NTB reductions in any trade deal.

4.1 Currency Valuation Changes

The Commission cannot implicitly assume that relative currency valuations will remain static after the agreement, especially in the modern world of competitive devaluation. While the Treasury Department is obliged to address domestic and international currency issues, the Commission is well within its authority to include relative currency valuation changes as a factor in projecting future impacts of the TPP.

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[3] Business Dictionary: http://www.businessdictionary.com/definition/competitiveness.html#ixzz3vdFSNYN0

[4] Atkinson, "What really is competitiveness?", *The Globalist*, September 20, 2013, www.theglobalist.com/really-competitiveness.

It is well established that the US has run persistent, and generally increasing, trade deficits over the past four decades. The Peterson Institute for International Economics has asserted that, in 2012, twenty-two countries (representing one-third of global GDP) maintained persistently undervalued currencies.[5] That report also asserted:

> The largest loser is the United States, whose trade and current account deficits have been $200 billion to $500 billion per year larger as a result. The United States has thus suffered 1 million to 5 million job losses.[6]

The extent of undervaluation often overwhelms any tariff or NTB reduction. The jobs, trade and GDP impact are substantial.[7]

The Commission would be remiss to neglect the topic of currency in its report on the TPP.

4.2 Border Adjustable Taxes/Fiscal Devaluation

The Commission should consider the impact of increasing border adjustable taxes which can negate any tariff reductions. Many past trade agreement signatory countries have increased their border adjustable consumption taxes after the trade agreement went into effect. These taxes are generally far higher than prevailing tariff levels. American exporters pay those foreign taxes at the border, and foreign companies receive a substantial tax rebate when shipping product to the US.

For example, Mexico created a 15% value added tax after agreeing to the North American Free Trade Agreement (NAFTA). Canada increased the size and scope of its goods and services tax after agreeing to NAFTA. The Central American Free Trade Agreement signatories created a 12% VAT after agreeing to the CAFTA-DR. Japan had a 5% VAT three years ago, raised it to 8% now, and will raise it to 10% in April 2016.

VAT increases can be a tariff replacement, or mercantilist strategy. It can mimic a currency devaluation in terms of trade competitiveness. This strategy is called Fiscal Devaluation.

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[5] Bergsten and Gagnon, Currency Manipulation, the US Economy and the Global Economic Order, Peterson Institute for International Economics, Number PB12-25, December 2012.

[6] Id. at 2.

[7] Some economists presume that a persistent trade surplus cannot occur because currency valuation changes will eliminate any persistent surplus. If the Commission were to adopt this view, then the Commission must find that trade balances and jobs are never impacted by tariff and NTB elimination or by any provisions of any trade agreements. CPA does not adopt this view because persistent current account imbalances are highly correlated with persistent currency undervaluation.

Fiscal devaluation as a national trade competitiveness strategy was described and revealed in a 2012 paper entitled “Fiscal Devaluations”.[8] In summary, a country can mimic a currency devaluation through fiscal means. If a country increases its VAT, then the cost of foreign and domestic goods is increased. However, if the country offsets the domestic tax increase impact with a reduction in other domestic taxes, then the cost of the domestic product remains the same. The price of foreign products is increased because of the increased VAT. The price of domestic products in the domestic market remains the same because the increased VAT is offset by the decreased domestic taxes. The price of exports is reduced because the VAT is rebated at the border and the domestic products also benefited from the domestic tax reduction.

While past economic reports have asserted that the VAT is trade neutral, they did not consider the recent Fiscal Devaluations findings. Those past reports assert VAT-trade neutrality on two grounds. First, any VAT-only approach raises the price of foreign and domestic goods equally so no trade impact is logical. Second, even if there is a trade impact, currency valuations will adjust to neutralize any domestic advantage.

Neither of those VAT-trade neutral theories consider (1) the Fiscal Devaluations strategy of offsetting domestic tax reductions or (2) the context of persistent currency undervaluation.

As a result, the Commission should not assume that border taxes remain the same when using the CGE or any other model. Border adjustable consumption taxes have increased steadily over the last forty years. Indeed, the Commission should account for the rise in Japan’s VAT to 10% which will occur in April 2016.

4.3 State-Influenced Enterprises and Industrial Subsidies

The Commission severely underestimated the impact of subsidies of state-influenced and national champion firms in tradable goods sectors with regard to its analysis of permanent normalized trade relations (PNTR) with China.

State capitalism does not conform to western free market econometric modeling. Vietnam, Singapore and other TPP countries have state-owned or state-influenced industries. Japan has national champion industries. Those industries are provided with direct and indirect subsidies and often produce according to a national plan. They can receive low-cost inputs, financing and fiscal assistance that private firms cannot. Lenders know those companies will not be allowed to fail, so they can receive favorable credit terms.

Current trade agreements do not directly address state-influenced enterprises. We know now that those market distortions can be immense, based upon the experience of China. While the TPP contains some terms regarding state-influenced entities, those restrictions cannot be assumed effective. For example, a signatory state can own a plurality of the company’s shares, appoint a plurality of the board or appoint the executives within the TPP rules and retain effective control. Vietnam, Singapore, Malaysia and other countries can easily reorganize existing entities to be within the letter of the TPP without making any substantive changes in control.

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[8] Farhi, Gopinath and Itskhoki, Fiscal Devaluations, Federal Reserve Bank of Boston, No 12-10, October 18, 2012.

Further, China can easily incorporate a subsidiary of its state entities in a TPP country like Vietnam and drastically increase its documented (even if not real) production within the TPP region to receive any benefits provided to TPP country firms.

As a result, the Commission should consider the impact of future subsidies of state-owned, state-influenced and national champion enterprise subsidies which are often immune from market forces and responses to price, supply and demand. Standard equilibrium analysis are likely insufficient for this task.

4.4. Certainty Against Future Tariff Increases Creates Exaggerated Offshoring and Job Destruction

Certainty that tariffs will not increase in the future has been shown to exaggerate the offshoring and job destruction effects of trade agreements in ways that standard economic theory does not predict. In other words, the mere fact of permanently fixing tariffs incentivizes US industry offshoring, increases job destruction and suppresses job creation. The Commission should consider this dynamic.

Consider the case of permanent normalized trade relation status with China. In 1999 to 2000, Congress considered and ultimately passed legislation granting permanent normalized trade relations (PNTR) status to China. Prior to that time, China benefited from temporary NTR which congress had to renew each year. PNTR merely made the temporary, but annually renewed, NTR tariffs permanent.

The Commission, at the time, estimated that the China-WTO deal would increase U.S. exports to China by an average of 10.1% and U.S. imports from China by 6.4% (USITC 1999, TableES-4, xix). That estimate turned out to be very inaccurate. Instead, offshoring to China dramatically increased, manufacturing in the US dramatically declined, and job destruction in the US was tremendous.

A recent study by the National Bureau of Economic Affairs found that the PNTR status provided the certainty needed for China to focus its state strategy upon exporting to the US because there was no threat of future tariff increases.[9] It further found that this certainty enabled US firms to confidently move their US operations to China.

> Beginning with an analysis of employment growth at the industry level, we find negative and statistically significant relationships between reductions in import-tariff uncertainty and relative industry employment growth up to six years after the 2001 peak. …
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> We find that PNTR is associated with both exaggerated job destruction and suppressed job creation.[10]

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[9] Pierce, Schott, "The Surprisingly Swift Decline of US Manufacturing Employment," National Bureau of Economic Affairs, NBER Working Paper No. 18655, December 2012.

[10] Id at pg 2, 3.

As a result, we have the largest bilateral trade deficit in history with China. A result the Commission failed to foresee.

As to the TPP, the mere fact of permanently reducing tariffs with no threat of future increases can provide the incentive for other TPP countries to focus their policies upon targeting the US market for exports far more than western econometric models would predict. This policy certainty also enables US firms to consider moving their operations to other TPP countries when they would not otherwise do so.

The Commission should now incorporate this connection between future tariff certainty and exaggerated offshoring and job destruction in its report on the TPP.

4.5. Developed vs. Developing Economies in the TPP Impact Trade Performance

The Commission should upgrade its analysis of trade outcomes through considering whether welfare always increases for all trading partners in all circumstances. We previously mentioned that US trade performance was poor with regard to past trade agreements with large, developed economies than with small, less developed economies. Ralph Gomory and William Baumol predict this developed vs. undeveloped economic effect in the book, *Global Trade and Conflicting National Interests,* in which they adapt classical trade models to the modern world economy.

The authors demonstrated that increased trade (not simply trade agreements, but increase volume of two way trade) between a developed country (like the US) and a developing country often generates welfare improvements for both countries because there is little competitive overlap between the two economies. However, when the other country becomes more developed or is already developed, and trade volumes increase, win-win becomes win-lose as a matter of basic economic theory. In basic terms, because there is much more direct industry overlap and erosion of one or the other's market share, the direct competition causes one country to "lose". In other words, the improvement in one developed country's productive capabilities is often attainable only at the expense of another developed country's general welfare.

In the case of the TPP, several of the economies are developed and several are undeveloped. The largest TPP economies are developed and make the same or similar goods and services as the US. In the case of Japan, there is a state-directed capitalism and economic nationalism aspect to consider. The Gomory-Baumol model would predict that for other developed TPP countries to benefit, the welfare of the US would have to decline.

In the case of small, undeveloped TPP countries such as Malaysia, the Gomory-Baumol would project that the welfare of both countries would increase until such time as Malaysia become sufficiently developed to compete directly with the US in a wider array of industries.

The Commission should thus consider the nature of the various TPP economies in relation to the Gomory-Baumol model when drafting its report.

4.6. US Firms Will Not Gain TPP Market Access to the Exclusion of Competitors

Market access for US products and services in this multilateral agreement will not produce potential gains that could be expected in a bilateral agreement. US firms do not gain disproportionate market access because that access is shared with the other countries.

Many past trade agreements are bilateral. Thus, the only theoretical market access at issue is (1) US producer access to the other signatory's market and (2) the other signatory's producers access to the US market. The US market access to the trade agreement country's market can be argued to be beneficial because it excludes all other countries.

That is not the case here. The TPP is more like the NAFTA model in which market access is shared with other developed economies rather than exclusively gained by the US. NAFTA trade performance is among the worst of all past US trade agreements.

The TPP, with twelve countries, provides theoretical market access for eleven nations to any one nation. To the extent the US reduces tariffs to Australia, the agreement also provides ten other countries the same or similar access. The Commission needs a method to determine whether and how much US producers can sell in any TPP country market when competing firms from other TPP countries have similar access.

In our view, this multilateral agreement will likely provide little, if any, economic benefit arising from market access. For example, if there is a 5% tariff on imported widgets in Australia, five TPP countries produce widgets, and those tariffs are eliminated, then there is no relative competitive advantage for US widget producers in relation to other competition firms elsewhere in the TPP. An increase in US widget exports is thus unlikely in the absence of pent up demand found only for the US product that will be released by the TPP.

Consider industrial equipment. To the extent the US domiciled firm of Caterpillar is provided access to another TPP market, Japan's Komatsu also has the same or similar access. If the Commission cannot find a reason, within the scope of the TPP agreement, to determine that Caterpillar will have an advantage over Komatsu, then the Commission cannot credibly find increased US exports resulting for that industry.

As a result, it is far less likely that the Commission can find increased exports in this multi-lateral agreement, in comparison to bi-lateral agreements, because market access is provided to all other countries which produce products that compete with US products.

4.7 ROO/Third Country Content Rules will Lessen the Benefit to US Firms

The Commission's analysis should consider that the rules of origin (ROO) in the TPP are less than 100% in all cases and often less than in past agreements. It should consider the percentage of US content currently in US exports and the percentage of third country content in other TPP countries' exports. The Commission should also consider the attractiveness of increasing third country content, which is allowed under the ROO, which could increase third country content to the exclusion of TPP country content.

As a result, the Commission should determine the extent to which the actual ROO erode the expected US exports in relation to ROO that requires 100% TPP regional content for favorable tariff treatment.

5. Commission Projections of GDP Should Include Net Trade as a Factor

CPA questions the Commission's past analysis of GDP in its past trade agreement projection reports. Those past reports include a GDP analysis, but use atypical GDP calculation methods excluding net exports.

The typical calculation of GDP, which is well known, includes this: private consumption + gross investment + government investment + government spending + (exports - imports). [11]

However, the ITC calculates changes in GDP from trade agreements as "specific changes in payments to primary factors of production (land, unskilled labor, skilled labor, and capital) and a change in the net transfer from households to the government."[12] There is no indication of "net trade" in the ITC's GDP calculation and no reason given as to why the typical "C+I+G+NE" method is rejected.

The Bureau of Economic Affairs calculates GDP[13] utilizing net trade in its monthly and quarterly reports, noting that exports add to GDP while imports subtract. This method is, of course, basic, accepted and standard.

CPA recommends that the ITC strongly consider utilizing the "C+I+G+NE" method to calculate GDP for purposes of this investigation and for purposes of examining the overall impact of trade deals and the US balance of trade with the world.

6. The Commission Should Improve Calculations of Jobs Impact

The ITC now has sufficient data to compare its past job creation projections arising from trade agreements to the actual results. The Commission should use that data to improve the accuracy of its analysis for the TPP report. In doing so, the Commission should not presume "full employment" in the US (which is relatively rare) and should comment upon other government agencies use of "trade related jobs" calculations so as to provide the best information to Congress and the public.

The CGE model assumes full employment when determining employment impacts of trade agreements, but of course full employment is not always the case. The Department of Labor's report on the Korea trade agreement found that employment impacts could range between

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[11] Boundless. "Calculating Real GDP." Boundless Economics. Sep. 17, 2015, www.boundless.com/economics/textbooks/boundless-economics-textbook/measuring-output-and-income-19/comparing-real-and-nominal-gdp-94/calculating-real-gdp-357-12454/

[12] *U.S.-Australia Free Trade Agreement*, Investigation No. TA-2104-11, USITC publication 3697, May 2004, pg 29.

[13] National Income and Product Accounts Gross Domestic Product: Third Quarter 2015 (Third Estimate), Bureau of Economic Affairs, Dec 22, 2015, www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm

“negligible” to a positive 280,000 using the CGE model and assuming full employment.[14] The Commission should provide analysis regarding employment impacts without assuming the relatively rare situation of “full employment”.

Further, since the US trade deficit with Korea has worsened since implementation of the KORUS agreement, the Commission should consider the actual employment impact when considering the TPP. This is because Korea is the most recent study employed by the Commission as to a trade agreement a large economy.

CPA recommends that the ITC discuss and analyze alternative job creation claims asserted elsewhere in the government as part of its statutory duty to consider alternative analysis.

For example: The International Trade Administration (ITA) asserts:

> In 2014, every billion dollars of U.S. exports supported 5,796 jobs, down from 7,117 jobs per billion dollars of U.S. exports in 2009.[15]

The Commission should consider the underlying analysis giving rise to this ITA claim presented to the public. The Commission should further consider the loss of jobs which stem from losing businesses and industries to foreign import competition. Is the method underlying this assumption appropriate for the Commission’s employment projections? Why or why not?

Other executive branch officials have asserted, in public opinion articles, that:

> Completing the Trans-Pacific Partnership provides the opportunity to open up markets, lower tariffs and, according to the Peterson Institute, increase U.S. exports by $123 billion and help support an additional 650,000 jobs. [said Agriculture Secretary Vilsack][16]

Is the Peterson institute report utilized by Secretary Vilsack an appropriate and reliable method to project the employment impact of the TPP? Why or why not? Media reports suggest that the authors of the report disclaim any connection between trade flows and job creation.

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[14] Report On The U.S. Employment Impact Of The United States – Korea Free Trade Agreement, U.S. Dept. Of Labor, pp. 16-17, https://www.dol.gov/ilab/reports/pdf/southkorea_EI.pdf

[15] Employment and Trade, International Trade Administration, www.trade.gov/mas/ian/employment/

[16] Steve Sanoski, “Trans-Pacific Partnership would benefit La. ports and economy, US ag secretary says”, *Greater Baton Rouge Business Report*, January 26, 2015, www.businessreport.com/article/trans-pacific-partnership-big-la-ports-economy-us-ag-secretary-says

"The reason we don't project employment is that, like most trade economists, we don't believe that trade agreements change the labor force in the long run. [said Peter Petri, Peterson Institute of International Economics].[17]

We do not ask the Commission to merely wade into punditry claims asserted in the media. However, Congress has statutorily requested ITC to provide objective guidance on this topic and to consider alternative methods not used by the Commission.

In sum, the ITC should provide a full perspective on the net job creation impacts expected from the TPP. It should also discuss (1) the analysis underlying executive branch job creation assertions those noted above, (2) the actual impact of past trade agreements on net job creation; and (3) whether the Commission's past net job creation projections were sufficiently accurate.

7. Summary

Thank you for allowing CPA to present this information for your consideration. We appreciate the Commission's role in providing accurate analysis to Congress and the public utilizing the best available methods and the best available data.

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[17] Glenn Kessler, The Obama administration's illusionary job gains from the Trans-Pacific Partnership, The Washington Post, January 30, 2015, https://www.washingtonpost.com/news/fact-checker/wp/2015/01/30/the-obama-administrations-illusionary-job-gains-from-the-trans-pacific-partnership/