TPP may benefit both global businesses and the developing countries where they operate

At times, negotiations have been close to failing in the Trans-Pacific Partnership (TPP), the free trade area (FTA) being negotiated by 12 countries in the Americas, Asia, and the Pacific. These difficulties can be explained by two main factors. First, countries involved (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam) are geographically dispersed and economically quite heterogeneous in terms of development, size, and type of regime. These geographical, economic and political differences have often been an obstacle to reaching a deal. In particular, the road to cooperation between democratic and authoritarian regimes and between free-market and state-led economies has been often paved with mutual distrust. The hard-nosed negotiations faced by China, Russia, and Vietnam to enter into the World Trade Organization (WTO) demonstrate this stumbling block.

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Second, the TPP is not only about cutting tariffs, but is also about reducing behind-the-door barriers. In fact, many would go as far as to say that the TPP is mostly about reducing regulatory non-tariff barriers. While the TPP aims to be particularly ambitious on these issues, this is hardly a new phenomenon. According to the DESTA database, the number of trade agreements including detailed provisions regulating investment, government procurement, and services, protecting intellectual property rights, and enhancing competition policies has been steadily increasing over time. Not surprisingly, this trend is particularly pronounced for trade agreements between North and South countries. In sum, in the era of a major WTO round deadlock, agreements like the TPP have the ambition of being instruments of trade governance rather than mere tariff deals.

Given that countries negotiating the TPP are all members of both the WTO and trade agreements, it is fair to ask is what would actually be the economic benefits of concluding this deal. According to Paul Krugman, the TPP is no big deal. In fact, Krugman advised President Barack Obama not to spend political capital on this pact. His argument is that tariffs are already quite low and so the benefits would be trivial. While sound, the argument is somewhat simplistic. First, average tariffs are low, but they are still quite substantive in some industries. For instance, Japanese tariffs on beef are roughly 40 percent. Second, economic benefits from removing non-tariffs barriers would be quite sizable, especially in countries like Australia and Mexico. Third, economic studies, such as this one by Trefler, have already shown that even relatively small tariff cuts produce significant increases in productivity in the long run.

If the benefits are not trivial, who is going to reap them? According to Krugman, the real beneficiaries of the TPP are going to be Big Pharma, which will see a further increase in their profit. Similarly, Joseph Stiglitz believes that the TPP would increase the power of multinational corporations, jeopardizing American jobs and worsening inequality. The argument that benefits are likely to be concentrated is confirmed by a recent working paper on US trade agreements and foreign investment. According to our recent study, trade agreements produce a substantial reallocation of sales from the least productive to the most productive US affiliates in host markets. In other words, even among a very selective sample of US multinational corporations (MNCs) involved in global production, only a handful reap significant benefits from preferential liberalization, whereas many lose.

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In which way would the TPP help US MNCs? While regulations and non-tariff barriers matter, old-fashion tariffs remain pivotal. Specifically, offshoring activities, i.e. affiliate sales back to the home market, respond to tariff cuts implemented by the US. This is because cutting tariffs cuts production costs for MNCs. By benefiting large corporations involved in global production networks, even the TPP is likely to create an unexpected collusion between MNCs based in North countries and governments of South countries. Indeed, MNCs have incentives to lobby for tariff reduction in their own home markets, where goods are ultimately shipped back, rather than in host markets. Given this unusual alliance between North MNCs and South countries, it comes as no surprise that, according to a recent survey by the Pew Research Center, the Vietnamese are the most TPP-enthusiastic.

A final note should be made with regard to China. An alternative way of looking at the TPP is that the deal is all about China. Specifically, the US aims to lock in its own regulations and standards before China becomes an ever more relevant actor eager to do the same, especially in its own backyard. A recent working paper by Robert Gulotty and Li Xiaojun ("Domestic Responses to Global Production Diversion: Evidence from Chinese Manufacturing Firms" 2015) shows that the cost of being excluded from the TPP can be significant for Chinese firms involved in global production activities. Indeed, Chinese firms, especially state-owned enterprises, are likely to face investment discrimination in terms of higher non-tariff barriers in those markets negotiating the TPP. To conclude, although it has been a long drawn-out process, all signs point to the TPP eventually being signed. When that happens, the TPP will be a landmark agreement on par with NAFTA.

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