

## Economic Policy Vignette 2.17.16

# Why the TPP?

## It's Good for Our Economy and Our Role in Asia

January 2016

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This *Economic Policy Vignette* is adapted from a statement presented by the author at the International Trade Commission Hearings on the Trans Pacific Partnership, Thursday January 14, 2016.

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## Introduction

The 12-member Trans Pacific Partnership (TPP)<sup>1</sup> is an exceptionally important trade agreement, and certainly the most important since the Uruguay Round of 1994. It is significant because of the new commercial opportunities it provides US industry and the impact it could have on trade relations in the vast Asia-Pacific region. It improves existing agreements and extends the rule of trade and investment law to five new countries including Japan.

Possibly the TPP is more important than the World Trade Organization (WTO). Its provisions span a wider range of issues and are more ambitious in depth of commitments. For example, the WTO's General Agreement on Trade in Services (GATS) did not provide many commitments to liberalize trade (many countries took very few commitments to liberalization).

The US can use the TPP as a springboard to engage non-member Asian economies, e.g., Korea, Indonesia and others, to build a giant trading bloc and to give us superiority in commerce in the region for years to come.

Failure to ratify TPP would hurt the US, cheating our economy of the advantages it offers. It would seriously scar our credibility not just in Asia but also in other negotiations now in progress, such as the Transatlantic Trade and Investment Partnership (TTIP) and the Trade in Services Agreement (TISA). With TPP ratification, the US will be positioned to lead the economies of the Asia-Pacific, but without ratification our loss of credibility would put us out of the game in the region for a decade, leaving the field to China. Some TPP member countries at first agreed to proceed with TPP only reluctantly – our record of implementation without renegotiation is not sterling. The US was able to convince these countries to proceed and – thanks to passage of the Trade Promotion Authority (TPA) – to close the deal.

## Focus on Services

According to the Peterson Institute for International Economics, US services companies will be the biggest winners from the TPP. It estimates that exports of US services firms will increase by \$68 billion by 2025, and services exports of all TPP members will increase by an estimated \$99 billion by that date.

The US services sector, as represented by the US Government's Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10), has concluded in its legislatively mandated report dated December 3, 2015, that the TPP "on balance provides new trade and investment opportunities, investor protections and other benefits for American companies and recommends that Congress implement it."<sup>2</sup>

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<sup>1</sup> Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, Vietnam

<sup>2</sup> <https://ustr.gov/sites/default/files/ITAC-10-Services-and-Finance-Industries.pdf>

While the ITAC's detailed report cites TPP's gains, it also enumerates "elements of TPP that could be strengthened, clarified or removed."<sup>3</sup> This agreement needs improvement through interpretive side letters and modifications, now and after its implementation. Some of TPP's shortcomings stem from the fact that its members include the world's most advanced countries (viz., the US, Japan, Australia and Canada) alongside countries with far less-sophisticated legal and regulatory systems and much smaller economies (viz., Malaysia, Brunei and Vietnam). Given these huge disparities, TPP's accomplishments are even more significant. That Vietnam could be persuaded to adopt wide-ranging market-based trade and investment rules would have been unthinkable just a few years ago.

The TPP provides solid gains for:

- professional services (e.g., accounting, architecture and engineering)
- audiovisual services
- electronic payments
- energy services
- express delivery services
- financial services

## Financial Services

Financial services are the lifeblood of global commerce. The Uruguay Round and its Fifth Protocol to the General Agreement on Trade in Services (adopted in 1997 pursuant to the WTO's built-in agenda) failed to provide an adequate body of rules and few commitments to open and fair trade and investment in financial services. Our bilateral FTA's made progress, but more is necessary, and TPP does that.

TPP provides the core commitments found in GATS and our FTA's: national treatment and most-favored national treatment, market access, cross-border trade, and transparency. It also provides: further provisions to strengthen freer payments and transfers; new investment protections; restrictions on imposition of nationality requirements on senior management and boards of trustees; and introduction of new financial services.

An important, new element in trade policy is to limit the anti-competitive advantages enjoyed by state-owned enterprises (SOEs) and particularly, for the financial services sector, the operations of post offices. TPP will significantly help level the playing field for US and other TPP insurers with Japan Post Insurance, the world's fourth largest insurer, which for decades has enjoyed favored treatment by Japan's government and has caused much political turmoil within Japan, and friction with the US.

Limiting "forced localization" is another newer element in trade policy, particularly localization requirements on data flows and the location of servers. The TPP provides for limits on these

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<sup>3</sup> <https://ustr.gov/sites/default/files/ITAC-10-Services-and-Finance-Industries.pdf>

practices but it does not apply to financial services. It is reported that this is because of the US Treasury's unwillingness to bind the US to such a regime. In insurance, the TPP does not prevent countries from intervening in the business of reinsurance (e.g., governments stepping in to assert control by requiring reinsurance to be placed locally, among other requirements).

Another very important objective has been removal of restraints on ownership of foreign investments. The TPP makes progress but with exceptions. An egregious example is Malaysia. Malaysia has consistently retained-- in the Uruguay Round, in the subsequent 1997 financial services agreement (the GATS Fifth Protocol), and in the failed effort to negotiate an FTA with the US-- rights to limit the amount of a foreign company's ownership of its investment, to force disinvestment, and, in the TPP, the right to screen such investment according to general criteria that allow wide administrative latitude. In fact Malaysia needs and works hard to attract foreign direct investment to fuel its aggressive infrastructure development agenda. Screens and the freedom of bureaucratic discretion they allow impair these objectives.

Another concern is the legal form by which a foreign investor may "establish" or set up its business. It has been a key objective of services trade negotiations since the Uruguay Round to remove restraints on what legal form an investor can use when establishing its business. National treatment is the goal: a foreign firm should be treated the same as a domestic one. Unfortunately TPP allows Malaysia, Singapore and Vietnam to continue to subsidize and discriminatorily advantage national companies to the disadvantage of foreign ones.

Another long-standing objective of trade policy has been to eliminate nationality requirements on individuals who serve as managers and on boards of directors. Brunei retains the right in TPP to require that insurance agents and brokers be citizens of Brunei.

The investment provisions of the TPP are especially important because US companies' foreign direct investment is so important to their provision of services in foreign markets. Most services companies require investment in bricks and mortar establishments in overseas markets in order to do business.

The agreement scores a big success in including for the first time in a trade agreement the right of financial services companies to seek remedies against discriminatory or unfair treatment through investor-state dispute settlement (ISDS) proceedings. Without ISDS, investment agreements are considered unenforceable. TPP's ISDS remedies include violations of the principle of minimum standard of treatment, and commitments to compensate for damages due to civil strife and for direct and indirect expropriations. They do not allow use of ISDS for violations of national treatment or MFN, which would be consistent with the US model BIT.

## **In Summary**

The TPP is a great step forward. Not implementing it would hurt us domestically and internationally. It needs fine tuning in some important respects but is overall beneficial to US services suppliers and to the national interest. It allows for improvements and for new members to join, and it will spur adoption of the rules of fair trade and investment across the region.