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January 13, 2016

Subject: Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors; Investigation No. TPA-105-001

The Commission’s report on the potential economic impact of the Trans-Pacific Partnership (TPP) comes at a turning point in American trade policy.

1. The World Economy – and Economic Thinking -- Has Changed

We all recognize that trade can be beneficial. The issue is not whether Members of Congress such as myself could pass an Econ 101 class, as President George W. Bush’s Chair of the Council of Economic Advisers, Gregory Mankiw, recently put it.¹ Instead, the issue is whether we are going to face up to the fact that our trading system today is much more complex than the simplistic trade model presented in an Econ 101 class. A growing number of prominent economists today recognize those complexities, from the Nobel laureate economists like Paul Krugman and Joseph Stiglitz, to Columbia professor Jeffrey Sachs, former IMF chief economist Simon Johnson, and former White House advisor Jared Bernstein. But too many want to pretend the question of a trade agreement is a “no brainer,” as Professor Mankiw suggests. Or that the benefits of trade “follows from the classic theory of trade gains first expounded by David Ricardo in 1817”² because, as Charles Krauthammer recently wrote, the “law of comparative advantage has held up nicely for 198 years.”³

What do David Ricardo and Adam Smith have to say about the inclusion of investor-state dispute settlement in our trade agreements? Nothing, to my knowledge. What do they have to say about providing a five-year or an eight-year monopoly for the sale of biologic medicines? About the need to ensure that our trading partners meet basic labor and environmental standards? How about the issue of currency manipulation? And what about trade in services on the internet or the offshoring of jobs that result from greater capital mobility? What does the theory of comparative advantage have to say about those specific issues? Nothing – and yet those are the kinds of issues at the crux of the debate over the TPP Agreement today.

So, how do the old ideas on trade fall short? Let me mention a few examples.

First, as Joseph Stiglitz pointed out recently, nineteenth century economics and the theory of comparative advantage assumed a fixed level of technology (i.e., no technological changes) and full employment. Those assumptions do not fit very well in today’s world.

¹ N. Gregory Mankiw, “Economists Actually Agree on This: The Wisdom of Free Trade”, The New York Times, April 24, 2015.

² Council on Economic Advisors, “The Economic Benefits of U.S. Trade”, May 2015, p. 7. Of note, the Council of Economic Advisers also made claims regarding more innovative activity as a result of trade (*see* p. 11-12), without clearly showing why this is true. I expect the Commission to avoid making such broad assertions with sound backing.

³ Charles Krauthammer, “Save Obama (on trade)”, The Washington Post, May 14, 2015.

Second, one of the most critical economic issues facing our country today is growing economic inequality and a stagnant middle class. Many trade economists believe that trade contributes to that inequality. But some try to downplay that fact by pointing out that other factors may contribute more to the problem, as if that means we should not worry about the impact trade is having. Consider this from Dani Rodrik, a Harvard University economist:

[T]he gains from trade look rather paltry compared to the redistribution of income. ... [I]n an economy like the United States, where average tariffs are below 5 percent, a move to complete free trade would reshuffle more than \$50 of income among different groups for each dollar of efficiency or 'net' gain created! ... [W]e are talking about \$50 of redistribution for every \$1 of aggregate gain. It's as if we give \$51 to Adam, only to leave David \$50 poorer.⁴

There is growing agreement among economists today that trade contributes to economic inequality in the United States, with estimates ranging from 10% to 50% of the total inequality growth.⁵ In a specific study of the TPP, economist David Rosnick concludes that, "under any reasonable assumptions about the effect of trade on inequality, the median wage-earner, and therefore the majority of workers, suffers a net loss as the result of these trade agreements."⁶ In other words, the economic pie may grow slightly as a result of our trade agreements, but the American worker with an average income is getting a smaller slice of that pie.

Similarly, the Brookings Institution has published an economic research paper by three economists (two affiliated with the Federal Reserve System) that found that trade and globalization accounts for the vast majority of labor's declining share of income in the United States over the past 25 years.⁷ Specifically, they found that "increases in import exposure of U.S. businesses can explain about 3.3 percentage points of the 3.9 percentage point decline in the U.S. payroll share over the past quarter century."⁸ But even this is an underestimate, the authors note, because the dramatic growth in executive pay is included in the payroll share and therefore masks the impact of imports on the average U.S. worker.

This underscores that the substance of the trade agreements – the international rules – matter. Our trade agreements must be designed to shape trade, to spread its benefits more broadly. Are they designed that way, and will they spread the benefits more broadly?

Third, we need to stop pretending that trade only has benefits and few costs. We need to stop talking exclusively about exports and downplaying the negative impact that some imports

⁴ Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy*, 2011, p. 57.

⁵ *See e.g.*, Paul R. Krugman, "Trade and Wages, Reconsidered" (Spring 2008) ("As I have said, it is likely that the rapid growth of trade since the early 1990s has had significant distributional effects. Putting numbers on these effects, however, will require a much better understanding of the increasingly fine-grained nature of international specialization and trade.").

⁶ David Rosnick, "Gains from Trade? The Net Effect of the Trans-Pacific Partnership Agreement on U.S. Wages" Center for Economic and Policy Research, September 2013, p. 5.

⁷ "The Decline of the U.S. Labor Share", Michael W.L. Elsby, University of Edinburgh; Bart Hobign, Federal Reserve Bank of San Francisco; Aysegul Sahin, Federal Reserve Bank of New York, Paper presented at the Fall 2013 Brookings Panel on Economic Activity, September 19-20, 2013.

⁸ Elsby et al., "The Decline of the U.S. Labor Share", p. 4.

have, as the Council of Economic Advisers did in a recent report.⁹ Of course, imports can help to lower prices for manufacturers and consumers. But lower prices do not do you much good if you have lost your job or seen your wage decline or stagnate. Again, as Jeffrey Sachs has said, “It’s true that the benefits often outweigh the costs, leading to the argument that winners can compensate losers. But in America, winners rarely compensate losers; more often than not, the winners attempt to trounce the losers.”¹⁰

2. Trade Agreements Have Changed, So the Economic Analysis of Them Must Too

To understand what economic questions Congress will want the Commission to answer in its report on the TPP Agreement, it is worth recalling some of the history of U.S. trade policy – a history that is strikingly relevant to TPP.

When I first came to Congress in the 1980s, Congress and a few trade policymakers were focused on Japan's massive efforts to create an export platform as its key to economic growth. Japan’s export platform was supported by an array of government measures, including the sanctioning of the “keiretsu” and the major manipulation of its currency. The United States was the major target, with massive growth in its trade deficit with Japan over two decades. In response, the Reagan Administration flirted with action, but rarely followed through. Calls for action, especially from House Democrats, were overwhelmed by opponents who often invoked the haunting legacy of Smoot Hawley Tariff Act and, as is true for domestic policy, the power of free markets. Under this prevailing doctrine, problems with “free” trade would work themselves out – the less government intervention, the better. Some of this debate was not surprising, as it reflected more general differences about the role of government in the market. But what was, and still is, strange is the unwillingness of some to respond to foreign government intervention in the markets.

The North American Free Trade Agreement (NAFTA) in the early 1990s became the next major challenge. With NAFTA, however, the equation was different: this was not another nation decisively crafting its resources and policies to challenge U.S. production. Instead, the biggest issues with NAFTA related to multilateral companies, mostly American, competing, in part, based on production in Mexico grounded on cheaper labor and unregulated environmental conditions. Although there were many other trade elements in NAFTA, labor and the environment became the focus of the raging debate in Congress. The need to shape trade became clear during this time, to avoid a ‘race to the bottom,’ and to ‘level up, not down.’ But how those issues fitted into broader fundamental questions about how to approach international trade began to be lost as the debate on international trade became more and more polarized overall, reflected in the harmful debacle at the WTO meeting in Seattle at the end of the decade.

In 2007 when Democrats took the Majority in the U.S. House of Representatives we made it clear that we were not going to consider the Peru, Panama, Colombia and Korea Free Trade Agreements (FTAs) as negotiated. Each of them would need to be fixed. We developed what became known as the “May 10th Agreement” on labor and environmental standards in trade

⁹ Economist Jeffrey Sachs responded to this report by the Council of Economic Advisers. See Jeffrey Sachs, “The Economic Benefits and Costs of U.S. Trade”, presented at a Christian Science Monitor Breakfast, May 7, 2015.

¹⁰ *Id.*

agreements. For the first time, fully enforceable labor and environmental standards would be placed into our trade agreements on equal footing with every other commercial provision. The May 10th Agreement also included important provisions on medicines, investment, and government procurement.

Then, in 2011, with the Korea FTA, working on a bi-partisan basis with then Chairman Dave Camp – and with Ford Motor Company and the United Auto Workers Union (UAW) – we urged the Obama Administration go back and re-negotiate the specific automotive market opening measures with Korea.

During this period, trade with China increased and became the focal point in the debate over international trade. With China in a position to become a Member of the World Trade Organization (WTO), with or without an agreement with the United States, Rep. Doug Bereuter and I introduced an amendment to tighten the conditions under which China would receive Permanent Normal Trade Relations with the United States. Included was a provision to allow the United States to act unilaterally against surges of Chinese products into the United States. The Bush Administration repeatedly refused to utilize it. China went on to build economic growth based on an export platform based in substantial measure by repeated manipulations of its currency, similar to Japan in the 1980s, as well as use of state-owned enterprises. Some experts gauged the loss of American jobs as a result of China's manipulation of its currency as ranging between 1 to 5 million. This occurred during decades long wage stagnation for the American middle class, at the same time as wage and wealth inequity in the United States was skyrocketing.

TPP has been negotiated – and is being considered by Congress – in this context and as the overall debate has intensified over the impact of international trade on the lives of American families. The twelve parties involved in the TPP negotiations – accounting for 40 % of the world GDP – include economies ranging from some of the world's largest, most market-oriented economies to some of the smallest, least developed command economies. We have never been able to establish a level playing field with Japan – after decades of trying, and multiple agreements to solve various problems – the Japanese market remains virtually closed today in key areas like agriculture and autos. And we have never negotiated a free trade agreement with a communist country like Vietnam where state-owned enterprises are a major concern and the Communist Party and the one so-called labor union are one and the same.

Trade agreements today go far beyond their traditional scope, addressing a vast range of international economic issues. As Professor Jeffrey Sachs of Columbia University said recently, “TPP ... would be better described as [a] Multinational Business Agreement[], involving three distinct areas: international trade, cross-border investment, and international business regulation.” The TPP covers a range of subjects far beyond those negotiated in any previous multilateral negotiation, concerning everything from intellectual property and access to medicines, to financial regulations, food safety measures, basic labor and environmental standards, cross-border data flows, and state-owned enterprises.

3. The Commission's Economic Analysis

The Commission is now charged with undertaking an economic analysis of this extraordinarily complex Agreement and its broader context, and with just 105 days to do so from the time the Agreement is signed. It will need to cut through the simplistic and prevalent generalizations in the debate today that trade is categorically good or bad. So often the main message from those who favor a trade agreement is their focus on exports and how jobs relating to them pay higher than the average. Analyses in opposition to trade often do mainly the opposite, positing the number of jobs mathematically for each quantum of the trade deficit. In its report on TPP, it is critical that the Commission dig far deeper into the likely economic impact of this agreement.

The most recent example of an economic analysis of the TPP was completed by the World Bank and was released just last week.¹¹ The World Bank's analysis suggests that the TPP will result in a 0.3-.0.4 percent rise in total, cumulative GDP¹² in the United States by 2030 – a very small figure.¹³

In my view, the World Bank report raises a number of issues regarding the manner in which typical economic analysis of trade agreements are completed, and which I hope the Commission will avoid. First, the World Bank bases its analysis on the computable general equilibrium (CGE) models, which has a number of defects. For one, the CGE models used by the World Bank also assume full employment, only allowing for the possibility of job losses or gains in the adjustment phase to an agreement. This is striking, given that the first focus of the debate in Congress and at kitchen table throughout the country and the TPP region is on the job impact of trade and trade agreements like TPP.

Second, the authors conclude that tariff cuts account for only 15% of the increase in GDP resulting from the TPP, with cuts in non-tariff barriers accounting for the remainder of the gains. But the authors merely *assume* that the provisions in TPP will eliminate some portion of the non-tariff barriers without analyzing the obligations in any detail. The authors also acknowledge that these “barriers” include “regulations that increase consumer welfare.”¹⁴ It is not clear whether the authors view legitimate consumer welfare regulations as unnecessary restrictions on the free flow of trade.

Third, TPP is about much more than cuts in tariffs (which some are describing as “tax cuts”¹⁵) and non-tariff regulatory barriers. Many provisions in TPP focus on setting higher

¹¹ World Bank Group, “Global Economic Prospects: Spillovers amid Weak Growth”, Chapter 4 – Potential Macroeconomic Implications of the Trans-Pacific Partnership (hereinafter World Bank TPP Report) (January 2016).

¹² Of note, I do agree with the World Bank's focus on GDP, and not Gross *National* Product (GNP). GDP estimates what we produce in the United States, while GNP also includes economic activity “owned” by Americans in other countries. In analyzing the TPP's impact on U.S. wages, it will be much more important to analyze GDP instead of GNP. I expect the Commission to focus on GDP in this regard as well.

¹³ See World Bank TPP Report, p. 227.

¹⁴ World Bank TPP Report, p. 235.

¹⁵ See e.g., “White House Compares Trans-Pacific Partnership's Tariff Cuts to Tax Breaks: Pitch for TPP spotlights select agricultural and manufactured goods that will see tax cuts”, Colleen McCain Nelson and William Mauldin, The Wall Street Journal, October 7, 2015.

standards on issues from intellectual property, to worker rights, to the environment. The World Bank report does not attempt to estimate the impact of these provisions. They do acknowledge that the labor and environmental provisions could have an impact “if fully implemented.” However, while recognizing that labor and environmental provisions may achieve other regulatory objectives, they conclude that “tightened labor and environmental regulation could reduce competitiveness and GDP gains” for some TPP parties. It is deeply troubling that the authors recognize what they see as the costs of higher labor and environmental standards without recognizing their many economic benefits.

Finally, if one reads between the lines, the World Bank report appears to conclude that TPP will increase inequality in the United States. But you have to read between the lines and could easily miss the entirety of the discussion of this critical issue: “[P]articipating advanced economy members are likely to experience a slight increase in skill premia while others benefit from a higher increase in the wages of unskilled workers. In the United States for example, changes in real wages are expected to be small as unskilled and skilled wages increase by 0.4 and 0.6 percent, respectively, by 2030.”¹⁶ It is interesting to note that the authors expect wages of both skilled and even unskilled workers in the United States will increase slightly, even though the World Bank predicts a small increase in U.S. GDP. Others, such as Rosnick, described above, reach the opposite conclusion. Clearly, how TPP will affect inequality and wages in the United States and in other countries deserves much more attention than this report provides.

The entirety of the Commission’s upcoming report needs to reflect all of these points: how trade policy and economic thinking has changed over the years; how the TPP countries are a very diverse group; etc. But more specifically, I urge the Commission to consider the following points:

- The Commission should disaggregate its conclusions and “show its work” as much as possible. For example, the gains to consumers from cheaper imports should be disaggregated from the gains that result from any increase in U.S. exports or net exports, and the costs associated with increased imports should also be delineated. This is particularly important given that there is a growing concern – one that the President himself has expressed – that the U.S. economy is too dependent on consumption. The data underlying the Commission’s analyses should also be made available for public downloading so that others can perform additional analyses and examine the assumptions used in the Commission’s model.
- The Commission should estimate not only the long-term impact of the Agreement, but its impact in the short-term, including any costs and benefits associated with the transition. Further, most economic models of trade agreements assume a fluid labor market in which, if someone loses their job, that person can easily find a similar job. However, in reality, the loss of one’s job is one of the most traumatic and costly experiences a person can have in his or her life. And it is often very difficult to find a new job. When a worker loses a job in the manufacturing sector due to trade, and is eventually re-employed, the new job is often at a lower wage than the worker had previously earned. And oftentimes the worker needs to uproot his or her family and relocate. That can be

¹⁶ World Bank TPP Report, p. 228.

very difficult to do for purely economic reasons. For example, if a factory that is a major employer in a town in Ohio closes due to import competition, housing prices drop dramatically and workers are left with mortgages that exceed those prices. Relocating for another job could therefore be extremely or prohibitively costly. Perhaps the trade agreement creates a new job in retail in another state. But economic models that blithely conclude from this scenario that there is no net job loss miss the point in so many ways. The Commission should analyze the ability of workers in sectors negatively affected by the TPP to be able to find commensurate employment after losing their job.

In sum, the Commission should also avoid assumptions that are unrealistic at least in the short term, such as full employment.

- There are claims being made on both sides about the impact that our trade agreements have on the U.S. trade deficit. Some argue that trade agreements have only made our deficit worse, while others claim that trade agreements have helped to shrink it. Then there are economists who assert that trade deficits are the result of much larger macroeconomic factors than are not addressed in our trade agreements. Part of this equation is the impact of our trade agreements have on imports. While proponents of trade agreements often tout the benefits of increased exports, the Commission needs to fully consider the impact increased imports have had on our economy as well. And it would be helpful to hear from the Commission as to what impact trade agreements have on U.S. trade balances.
- The Commission should estimate the impact the Agreement will have on jobs, wages, and inequality. For instance, if the Commission finds that the U.S. economy will see gains from the TPP, in which sectors will those gains be realized? In other words, the Commission must explicitly examine who will win and who will lose as result of this agreement, with a particular focus on income distribution.

Specifically regarding wages, the Commission should analyze the impact of wages sector-by-sector, rather than by assuming a broad aggregate effect. In which sectors will wages go up – and by how much? In which sectors will wages go down – and by how much? In which sectors will there be downward pressures on wages? And within the issue of wages, the Commission should differentiate between executive compensation and other wages.

- What economic impact would compliance with basic international labor standards have in the TPP region, and will the TPP Agreement ensure compliance with those standards? What role will the labor standards in the TPP have on wages in the United States? If fully implemented, what impact will the rise in labor standards in certain TPP countries have on the wage pressure in the United States?

For example, Mexico today falls far short of those standards. Its auto industry is growing by leaps and bounds, and U.S. automakers are moving production there. Reflecting Mexico's failure to accord its workers internationally recognized worker rights, Mexico's

auto workers make less than a fifth what U.S. workers make. How would labor standard compliance affect competitiveness between the United States and Mexico?

- Will the investment protections and other provisions in the Agreement make it more likely that U.S. producers will offshore production to other TPP countries? What impact will these provisions have on the U.S. economy? And, if the Commission believes there is reason to expect labor and environmental standards will improve as a result of the Agreement, to what extent will those improvements offset the incentives to relocate that flow from the TPP investment protections?
- What impact will the intellectual property rules in TPP have on drug prices in the United States, and in other countries, particularly poorer ones? Would the Agreement make it more difficult to implement reforms in the United States, such as the President's request to reduce the term of biologics exclusivity from 12 years to seven? Given growing concerns over health care costs today in the United States, the Commission must address this problem in a thorough manner.
- What impact will the environment chapter of TPP have on the United States economy? As with labor standards, many have fought to increase the labor and environmental standards in trade agreements to ensure that international trade does not result in a race to the bottom where companies seek to produce goods in countries with the lowest labor and environmental standards? Does the TPP environment chapter ensure that this race-to-bottom does not occur and, thus, enhance U.S. competitiveness?
- What impact will the relative weakening of the automotive rules of origin in TPP have on the North American supply chain that has been greatly influenced by the stronger rules in NAFTA? Will some U.S. production of autos, auto parts, or other critical inputs such as steel likely be lost as a result of the change? Will the rules of origin promote sourcing from China and other non-TPP Members?¹⁷
- What issues aren't addressed in TPP that could nullify or impair the benefits of the Agreement? For example, an incredibly important issue that has traditionally been neglected in economic analyses of trade agreements is currency manipulation, even though currency values have such a big impact on trade flows. The finance ministers of TPP countries have agreed to a side "Declaration" regarding currency manipulation – what impact does the Commission believe this language will have on the practice of currency manipulation and on the U.S. economy broadly? How does the impact of previous episodes of sustained currency manipulation (e.g., China in the 2000s) on the

¹⁷ I understand that CGE models typically focus on the impact of changes in tariffs, but do not account for rules of origin. In addition, CGE models typically aggregate product data so as to make it difficult or impossible to look at the likely economic impact of a weaker rule of origin on a specific auto part. However, the Commission is perhaps uniquely positioned to analyze this issue, with its institutional knowledge of industries and its ability to reach out to industries, through questionnaires and other tools.

United States economy (in terms of GDP, wages, and inequality) have on any potential gains to the United States from TPP?¹⁸

Moreover, while many expect that the TPP will modestly open the Japanese agricultural market, there are also reports that the Government of Japan will increase its subsidies to farmers in order to offset that market opening. To my knowledge, disciplines on such subsidies are not included in the TPP Agreement. (They are included in the WTO Agreement, but it is unclear whether a WTO case will be filed to address these subsidies.) This is a clear example of a measure that could “nullify or impair” the benefits obtained under TPP – which is clearly prohibited by the TPP. The Commission should analyze the impact that these proposed Japanese subsidies, and others like them, will have on the ability of U.S. producers to actually obtain market access abroad.

The importance of the Commission’s report is highlighted by the lack of detailed analysis on many of the issues I discussed above. However, the impact of U.S. trade agreements is no longer a hypothetical issue, and no longer can we simply assume that the benefits of trade will outweigh its costs or that those who benefit will compensate those who lose. We must move beyond the clichés. NAFTA has been in place for more than twenty years and the economic analysis of trade over the past twenty years has also dramatically improved. I expect the Commission, in its unique position, to produce a thorough and nuanced analysis of the TPP. We need new models – and new thinking.

The Commission’s report will be a critical tool for Members of Congress and the American public to analyze the value of the TPP.

¹⁸ For instance, if Chinese currency manipulation during the 2000s resulted in between 1 and 5 million U.S. jobs lost, how does the Commission analyze the impact of potentially relatively small gains to U.S. GDP from TPP?