THE TRANS-PACIFIC PARTNERSHIP: SIZING UP THE STAKES — A POLITICAL UPDATE
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**Introduction**

When the US Congress passed a bill granting President Barack Obama and his successor fast-track authority to negotiate trade pacts, the world’s highest-stakes trade negotiation—the Trans Pacific Partnership (TPP)—cleared its biggest hurdle. Congress no longer threatens to block the deal, and lawmakers are expected to ratify a concluded agreement much more easily than they approved Trade Promotion Authority (TPA).

TPA comes at a late stage in the negotiations. For six years, trade officials have been hammering out the terms of an agreement. Most terms of the deal are considered settled, but a number of countries refused to play their cards on the most sensitive issues until US negotiators had TPA in hand. With fast track now in place, negotiations will pick up steam. The US and Japan, which have been driving the negotiations, are both motivated to complete an agreement well in advance of 2016 elections in each country. At the writing of this report, conclusion of a deal could come as early as August, but more likely in the fall. One unlikely scenario would see talks conclude in 2016. Even less likely is a scenario in which the deal breaks down altogether.

July should deliver substantial progress toward a conclusion. Early in the month, Acting Deputy US Trade Representative Wendy Cutler and Japan’s deputy chief trade negotiator Ambassador Hiroshi Oe led working-level meetings in Tokyo. Lead negotiators from the 12 member countries will meet just before a final ministerial meeting from 28–31 July, which will include US Trade Representative Michael Froman and Japan Economic Minister Akira Amari. Once the ministers finish a political agreement, lawyers will polish the text, which then must be made available to the US public for 60 days before Obama can sign the agreement.

Successful conclusion of the deal would lead to hundreds of billions of dollars of economic gains over the next decade through liberalizing tariff and non-tariff barriers across the Asia-Pacific, North America, and South America. It would also more tightly intertwine security relations among the participating countries, promote adoption of critical domestic reforms, and establish global economic norms on terms agreeable to mature capitalist countries. Because the benefits far outweigh the political costs for all countries involved, a successful conclusion is probable.

Nevertheless, firms and investors must also prepare for its failure. This scenario would create dramatically negative domestic and international blowback for most countries at the table, compounding the opportunity cost of forgone integration. Domestic reform in certain countries would slow, government instability might ensue, US credibility in Asia would be damaged, and a China-dictated path toward economic integration would gain more traction.

Eurasia Group initially released this report in April 2014 in a forward-looking attempt to size up the scale and scope of the deal’s success or failure by analyzing its strongest economic and sectoral implications and forecasting the key political and economic effects of success or failure at both the domestic and global levels. Here the political analysis is updated to reflect current considerations and bring forward the existing economic analysis for the purposes of showing orders of magnitude, as the data are now somewhat dated and do not reflect recent shifts in the global economy, such as the substantial drop in oil prices. Once the TPP is completed, Eurasia Group will issue a second update to reassess the actual economic and sectoral impacts of the deal as negotiated under up-to-date economic simulations.
Implications of concluding the TPP

The pact fills in major gaps of Pacific Rim trade liberalization among a group that accounts for 40% of the world’s GDP. Although some high-quality trade deals exist between TPP members, such as NAFTA (the North American Free Trade Agreement, which includes the US, Mexico, and Canada) and the P-4 (a TPP precursor made up of Brunei, Chile, New Zealand, and Singapore), many of the 12 countries are not trading freely with one another. Indeed, some have not negotiated any bilateral deals, and current trade is based strictly on most-favored-nation WTO standards. As a result, the deal will deliver plenty of meaningful tariff reductions.

The TPP countries have traditionally attempted to liberalize trade through three avenues: WTO deal-making, bilateral relationships, and regional trade accords. The need for consensus in the WTO
The TPP process has led to deadlock caused by the BRIC countries (Brazil, Russia, India, and China), as assertive emerging market nations have had little interest in concluding another global deal on developed-country terms. Bilateral deals struggled to find tradeoffs that would help build supportive domestic coalitions. Only in regional settings such as NAFTA and the EU, which create crosscutting gains among like-minded countries, have countries realized substantial liberalization. The TPP and the Transatlantic Trade and Investment Partnership (TTIP) aim to replicate their gains by expanding membership across continents.

Plenty of the TPP’s economic gains come from tariff reductions, but the deal ventures into uncharted territory. By addressing a range of 21st-century issues, the TPP will reduce the frictions that inhibit free exchange across borders by dealing with issues that are traditionally the sole purview of domestic governments. For instance, the TPP will harmonize rules on intellectual property laws, capital flows, and data transmission.
### Sectoral winners and losers under the TPP

All color coding is based on sector value-added % change in 2025 against baseline of no TPP:
- **Green** = winner
- **Red** = loser
- **Yellow** = neither winner nor loser
- Deeper shading represents a deeper effect.

Source: Petri et al

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Over time, the TPP has shifted in size and depth. The negotiation began with a restricted group that aimed for very high standards. As it grew and took on geopolitical importance with the addition of Japan, negotiators have sacrificed some depth for inclusiveness. For instance, the US hoped to impose strong rules on the activity of state-owned enterprises and open government procurement, but pushback from Vietnam and Malaysia has reduced US demands on such issues. This limits the deal’s ambition yet also increases its chance of success.

Though the TPP will not be as far-reaching as initially envisioned, the economic implications of its successful conclusion are profound. Under the TPP, GDP figures ten years following implementation—which in this report is pegged at 2025 but could be a bit later in that decade depending on final ratification—will be $285 billion above baseline predictions for member states and will increase exports within the bloc by $440 billion. For certain markets, the TPP alone would be a substantial driver of economic outcomes: Japan’s and Singapore’s 2025 GDPs would both be nearly 2% higher with it in place, Malaysia’s 5.6% higher, and Vietnam’s a staggering 10.5% higher.

Eurasia Group received access to the most robust TPP economic and sector simulation available to analyze the impact of the deal across all countries. Below, the key macroeconomic and sectoral implications are discussed for Japan, the US, Vietnam, Malaysia, Singapore, and Mexico, which are the countries that will see the deepest effects. In many cases, the strength of each country’s winners underscores the domestic political logic for proceeding with the deal. The potential loss of trade by China in the event of a successful TPP negotiation is also discussed.

**Domestic politics and economic effects of the TPP**

**Japan**

Prime Minister Shinzo Abe has made the TPP a core piece of his Abenomics strategy for promoting sustained, long-term growth. The agreement would bolster the momentum of efforts to implement domestic structural reforms, many of which entrenched interests have often blocked for years or even decades, though this process as a whole will remain slow. Abe is still popular, opposition parties remain weak and divided, and the ruling coalition comprising Abe’s Liberal Democratic Party (LDP) and the smaller Komeito party has majority control of both houses of the Diet. This dominant position enables Abe’s government to enact legislation or ratify treaties, including trade agreements, for which he has broad coalition support. LDP and Komeito members representing rural districts and groups in which opposition to the TPP is strong (for instance, among farmers) will continue to oppose a deal, but Abe will have sufficient political capital to ratify it over their objections. He and others in his government are keen to conclude and ratify the TPP as soon as possible to avoid making it a prominent topic of debate in the run-up to an election for the Diet’s upper house in July 2016.
Although many protected industries stand to lose from the TPP, the country as a whole would benefit significantly, with 2025 GDP forecast to be 1.96% higher and exports 11.16% higher than if there were no deal. Vietnam would grow more in percentage terms from the TPP, but Japan has by far the most to gain in absolute terms—$105 billion of additional output in 2025. Other dramatic effects include a jump in inward FDI by 39.8% over the same period, though this increase is from a very low base for a developed country and hinges entirely on an optimistic assumption that Japan follows through on proposed investment liberalization.

The growth in Japanese transport equipment is the second-largest absolute sectoral gain across all TPP countries. Opening regional markets to Japanese autos will propel a $21.5 billion value-added increase and drive a 24% boost in exports in 2025. Internal pressure on the Japanese government to promote autos have been somewhat lessened by the fall in the yen’s value since autumn 2012, which has boosted exports. However, expansion of auto sales in the US market in particular is a key goal and a primary reason why Japan joined the TPP. The US currently has a 2.5% import tariff on passenger cars and auto parts and a 25% tariff on light trucks, dating back to the early 1960s. These tariffs are expected to be reduced or phased out over time.

Japan’s negotiating priorities also include freer access to US LNG exports, the gains from which are not included in the economic model and would represent added economic upside. Japan is likewise focused on obtaining better general market access to TPP countries and protecting its tariffs on agricultural products. Japan’s wheat producers would suffer a nearly 40% hit in 2025, while rice and other farm products would suffer a 4%–5% hit. Final talks with the US, which will revolve around trading cuts to Japan’s agricultural tariffs for increased access to the US automotive market, will prove tense until the deal is closed. That said, Abe has weakened the power of agricultural cooperatives that vigorously oppose a deal and is prepared to marginalize or buy off other anti-TPP groups.

### THE TPP WILL LIBERALIZE US LNG EXPORTS TO ASIA

As US law permits unimpeded LNG exports only to countries with which the US has a free trade accord, the TPP in theory would expand the market for US natural gas. The country could export gas to TPP countries without a separate review and authorization by the Department of Energy (DoE). For Japan in particular, access to US LNG is a high priority. However, the effects of the deal on the energy market may not be quite as dramatic as they appear. The DoE has already been issuing timely project approvals for the past year, with ten projects already securing authorization to export to non-FTA countries, and the process has been expedited since the Ukraine crisis. Also, a risk has emerged for additional US LNG export projects owing to current market conditions, which have driven down LNG prices. The drop in oil prices continues to erode the price advantage of Henry Hub–linked supply relative to traditional oil-linked LNG, meaning the outlook is weaker for new final investment decisions for the next round of US projects. While the TPP would open exports to the sizable Japanese market, most US LNG projects would seek a broader customer base to justify investments, especially amid the pressure of a prolonged low-price environment. Nonetheless, the TPP would provide some symbolic relief to Japan in particular and can still be used as a negotiating chip by the US.
US

Obama deferred his trade agenda in Congress until the last possible moment, and his calculation paid off. Congress in 2015 is under full Republican leadership for the first time in Obama’s presidency. And it was those Republican leaders, including Senate Majority Leader Mitch McConnell and House Speaker John Boehner, who pushed the fast-track trade bill to the finish.

Now that the president has secured fast track, the TPP will be voted on by Congress requiring only a simple majority in both chambers; and lawmakers will not be able to amend the agreement. Because members of Congress have passed the difficult vote to give Obama trade authority, it is highly unlikely enough will reverse course in an effort to vote down an already signed TPP. But there are many steps remaining on the path to ratification, which do present a small risk that Congress may not approve the deal during this presidency. First, fast track requires the TPP text be made public for 60 days before the president can sign it. Once it is signed, implementing legislation must be drafted, Congress may choose to hold mock markups, committees must report the legislation, and each chamber must pass it. Because the 2016 election cycle will soon drag down the productivity of this Congress and make members less eager to make controversial votes, any unforeseen delays in the signing of the TPP or new political controversies surrounding it could cause final ratification to slip to the next administration.

Fast-track authority lasts six years, so it will outlive the Obama administration and empower his successor to not only ratify the deal, if necessary, but also to extend the TPP to other states such as South Korea or the Philippines, and to secure a free trade accord with Europe or pursue other bilateral trade deals.

Whereas the economic benefits are real, the drivers for US participation in the TPP are more geostrategic and geoeconomic, as discussed later in this report. With WTO liberalization stalled for the foreseeable future, the US is hoping to set the global terms of trade through regional megadeals. In particular, the TPP could provide a guide for Chinese reforms. From a strategic standpoint, the TPP supports the US’s larger rebalance to Asia, demonstrating US commitment to allies in the region.

The TPP will have a substantial but not overwhelming impact on the US economy. In 2025, US GDP will be $77 billion, or 0.38%, higher with the TPP than it would be without it. For the US, the addition of Japan made the TPP much more significant in strictly economic terms, as it tripled the potential output boost of the deal. Though the TPP does not dramatically enhance growth prospects for the US economy, it does raise exports by 4.39% over 2025 baseline forecasts. Scaling up US exports has been a major policy priority for the Obama administration since the second half of his first term, as the White House believes exports support the sort of high-quality, middle-class jobs needed for US growth and the reduction of inequality. US private services gain the most in absolute terms of any sector in any TPP country by 2025. At $39 billion, this sectoral gain makes up 60%
of the country’s total output increase. Depending on how much the final terms open the Japanese market, financial services, accounting, insurance, and other professional services are likely to make considerable gains abroad through TPP liberalization.

The trade, transport, and communications sector value-added in 2025 will also climb by $15.1 billion. The Obama administration has put an emphasis on liberalizing communication technology, promoting intellectual property protections, and writing rules to ease trading opportunities for data-driven industries. Given the US comparative advantage in this field, US corporations on the high end of the value chain will be expected to capture market share and drive increases in productivity in TPP member countries both in this sector and elsewhere.

Yet it is not all upside for the US: The country’s transport equipment sector is one of the TPP’s largest losers in absolute terms, as a deal would mean it would drop $9.7 billion from baseline 2025 output, nearly matched by US machinery, which would drop $9.4 billion. Enhanced liberalization will hit an already reeling US machinery industry. Low-end machinery in particular will be imported, and machine makers with declining clout will have a hard time pushing the Obama administration to keep parts of the market closed.

**Vietnam**

Vietnam will gain the most in relative terms from passage of the TPP. Its 2025 GDP will be 11%, or $36 billion, higher than without the trade pact. This percentage increase dwarfs the gains made by any other country. The export gains are similarly large, projected to increase by 28% over the same period. Vietnam has by far the lowest GDP per capita among TPP member states: $1,900 (the next lowest is Peru at $6,800), according to the IMF. Vietnam, therefore, will become a preferred destination for industries requiring low-wage labor to remain competitive. Sectors that need cheap wages, such as apparel, footwear, and to a lesser extent textiles, are poised to make huge gains.

The conservative wing of government led by Communist Party General Secretary Nguyen Phu Trong and Prime Minister Nguyen Tan Dung’s more market-friendly faction have forged a consensus around the TPP for different political reasons. Trong recognizes that social stability and long-term party legitimacy will benefit from trade liberalization that delivers the largest relative gains of any country. Trong recently reaffirmed Vietnam’s commitment to the TPP during a visit to Washington, making it clear in discussions with Obama that the Vietnamese government and the Communist Party—as well as factions of conservative ideologues and pro-business capitalists in both groups—are united in support of the deal. Dung’s backers see the TPP as an opportunity to push Vietnam toward self-reinforcing market reforms that benefit him and his allies in business.

Furthermore, Dung is in a strong position to control the outcome of the National Party Congress and government elections next year. His confidence is evident in his command of the policy...
agenda at the most recent National Assembly session that ended in June. With so many friends and comparatively weak enemies, it would likely take a self-inflicted wound such as a corruption scandal to damage the prime minister. This in turn means a more supportive environment for his capitalist, pro-business agenda. While some of the deeper-cutting reform requirements initially proposed for the TPP are likely to be stripped out of the final version, the policy continuity preserved by Dung’s retention of power would present the best opportunity to use the accord to support structural reforms. Internally this means a focus on cleaning up the banking sector and nonperforming loans to stimulate credit growth and consumption, while externally the primary policy commitment remains to the TPP.

Vietnam’s top priority is to loosen US protections on apparel and footwear imports to ramp up its exports. Vietnam’s apparel and footwear sector has the largest percentage upside for any TPP member at 50% growth over baseline in 2025, most of which comes at the expense of China. This sector’s absolute gain is higher than all but three other sectors in the US and Japan. This is particularly remarkable considering that Vietnam’s current GDP—$186 billion in 2014, according to the IMF—is dwarfed by that of other TPP countries.

The Vietnamese government is under extremely high pressure to secure access to US apparel and textile markets. Competition is fierce in this industry, and workers in the country have been making more labor demands. These can be met with productivity gains and access to US consumers, but a requirement that textile companies source material from TPP participants to benefit from lower tariffs would hurt Vietnamese producers who source primarily from Thailand and China. As a result, many Chinese companies have anchored new investments in Vietnam in the past year to ensure they are not cut out of the trade bloc. In addition, Vietnam can be expected to push for, and receive, carve-outs on hundreds of items.

Vietnam, along with Malaysia, was able to beat back some of the more stringent state-owned enterprise (SOE) provisions that could have forced what authorities viewed as premature reform and strong labor provisions that would guarantee the right to organize, triggering wage hikes that would erode Vietnam’s competitive advantage. However, the appetite for the TPP will remain high, as its benefits are now widely recognized among the political elite.

**Mexico**

In 2025, Mexico will get a 0.5% GDP and 3.8% export boost thanks to the TPP, with apparel and textile exports suffering reductions of 19.3% and 9.9%, respectively, as production is diverted to cheaper labor in Southeast Asia. Though aggregate effects may seem small, the deal will allow Mexico to sign free trade agreements (FTAs) with many countries for the first time and upgrade existing trade deals. Mexico still enjoys competitive labor costs for manufacturing compared with China. Growth sectors include minerals, transport equipment, machinery, and communications equipment, which will all grow by an extra $1 billion under the TPP. And the economic model of the agreement does not account for the
recent reforms to Mexico’s energy laws, which means the gains are likely underestimated. Investments in the entire energy sector should also support manufacturing competitiveness, and expanding pipeline capacity will allow greater natural gas imports from the US, in turn cutting production costs across the industrial sector.

While trade ties with the US are an important growth driver, the TPP and a complimentary deal—the Pacific Alliance, discussed below—are an opportunity to rebalance away from Mexico’s export dependency on the US. In the past ten years, the share of exports to the US has dropped from slightly more than 80% to near 70%. Even given these gains, this aim of diversification will continue to influence policymaking. There are no political constraints on the deal’s ratification. International treaties require only majority approval in the senate. The TPP would be backed by both the ruling centrist Institutional Revolutionary Party and the right-wing National Action Party, which together control 72% of the seats. There will not be a new senate election until 2018, so the majorities needed to pass the TPP are stable.

Malaysia

The TPP presents a substantial opportunity for Prime Minister Najib Razak’s National Front party to bolster exports and growth. With the TPP, Malaysia’s GDP would be 5.61% higher and its exports 11.9% higher in 2025. The country’s textile and apparel sectors would experience the highest percentage growth (18% and 37%, respectively), but other sectors higher up the value chain would see bigger increases in absolute value added. Electrical equipment ($6.8 billion value-added increase) and machinery ($4.7 billion value-added increase) in particular are poised to make big gains, helping Malaysia escape the middle-income trap its elected leaders so gravely fear. Many global supply chains of electronic equipment currently run through Malaysia, and the TPP would only expand their presence.

Najib has been very supportive of the pact in the face of some domestic opposition. He sees Malaysia’s inclusion as a strong driver of growth that would propel it into the ranks of developed countries. Adopting the TPP is a way to diversify Malaysia’s economy away from China, which is the country’s largest partner, by opening new markets to its export-oriented economy. Opposition parties as well as conservatives in Najib’s own party, such as former prime minister Mahathir Mohamad, have been vocal in their opposition to the deal. However, now that SOE rules are likely to be diluted and the US is pulling back on demands for substantial reforms to racial preferences for ethnic Malays, opposition to the TPP may weaken in time, allowing Najib to push back against conservatives in his own party.

The opposition to the TPP from civil society groups has largely fallen off the radar of public discussion. Yet opposition to the deal remains quite strong within the conservative faction of the United Malays National Organisation. With Najib facing a crisis of confidence driven by an allegation of financial misappropriation and his politically challenging fiscal reforms, he is not
likely to prioritize the TPP’s passage until the investigation against him loses momentum. Eurasia Group’s basecase scenario is that Najib will survive the series of scandals and attacks from within his own party. He is expected to remain committed to the TPP and regain his focus on getting the deal through despite these domestic challenges. Helping to weaken his opponent’s case, he will also work to ensure that Malaysia’s interests are addressed, particularly in areas that would undermine the country’s Malay-centric economic agenda. In the unlikely event that he is ousted and replaced by Deputy Prime Minister Muhyiddin Yassin, TPP negotiations could be derailed given Muhyiddin’s skepticism about international trade deals and his effort to pander to the anti-trade nationalist groups.

Singapore

Singapore will gain on multiple levels from the TPP’s completion. Alongside a 1.9% GDP boost and 4.3% export bump in 2025 and a slew of sectoral winners, Singapore’s benefits will have social and geopolitical dimensions. The island country was part of the P-4 trade deal, the precursor to the TPP-12, and is an outspoken champion of the new accord. As its economy has no natural resources and a small consumer base, Singapore’s growth must come from exports. The TPP provides the perfect venue for the government to advance a type of economic development that plays to Singapore’s strengths.

As widening inequality could threaten social tensions, the ruling People’s Action Party (PAP) is focused on creating high-quality jobs to ensure that the country’s economic success reaches the entire population. Given its economic benefits, the TPP has become more important for the PAP, which is facing considerable pressure to address social issues such as income inequality. The TPP has become an element in the party’s long-term plan to remain in power. While the opposition Workers’ Party won six of 87 parliamentary seats in 2011—its best result since independence—there is virtually no risk that Prime Minister Lee Kuan Yew and the PAP will lose control in elections next year. With most Singaporeans favoring the model of economic liberalism that has delivered transformative growth over the last generation, it is likely that Lee will tout Singapore’s leadership in the TPP negotiations as a success. However, the TPP is not a divisive issue in Singapore and enjoys full support from all political sides; consequently, it will probably not feature too prominently in the campaign.

From a geopolitical standpoint, Singapore also stands to gain. Trouble in the South China Sea threatens regional trade, which is Singapore’s livelihood. So the TPP’s contributions to regional stability by ensuring a US commitment to the region are substantial.

Singapore’s largest sectoral winner is electrical equipment, forecast to make a $2.5 billion, or 8.8%, value-added gain over baseline projections for 2025. Gains in the country’s strong semiconductor industry will outweigh additional challenges for personal computer–oriented electronics companies. Machinery, adding $500 million—a 2.9% increase—is one of the country’s largest...
sectors and will create the sort of high-paying jobs the government is looking to add to quell persistent social tensions. Trade and transport are also forecast to post a $500 million gain, though that increase may be understated as the model does not fully reflect heightened activity at the Port of Singapore. Government services and construction will both add nearly $1 billion.

**China**

Though not part of the TPP negotiations, the country will be affected as trade is diverted away from its economy and toward TPP signatory countries. If the pact is finalized and China does not sign on, Chinese GDP by 2025 will be 0.20%, or $35 billion, lower than otherwise forecast. Though the dollar amount is not large in comparison to China’s economy, other effects would be more longstanding. Especially once South Korea joins, the TPP would increasingly set trade standards for the Asia-Pacific region. China would face a significant loss of trade if it stays outside an ever-widening bloc underpinned by US- and Japan-driven trade principles.

The net-effect of these dynamics on China is positive: While its accession to the TPP is not expected any time soon, the deal itself will motivate Beijing toward more significant progress on reforms to intellectual property rights, market openness, and SOEs, in order to raise its economy closer to TPP-level standards. The enormous potential upside of FTAs with Japan and the US will also serve to draw China toward further liberalization.

There are already clear signs that the administration of Chinese President Xi Jinping is thinking along these lines. China has dropped its earlier official hostility to the TPP deal and has said that it will explore joining. The administration, at the same time, is pushing forward a number of regional bilateral FTAs, expanding a network of free trade zones domestically, and negotiating a bilateral investment treaty (BIT) with the US.

**Geopolitical implications**

The geopolitical implications of the TPP will have lasting importance. For the US, it will give heft to Obama’s “Asian rebalance” and reassure countries of the US commitment to the region. The trade deal is the critical economic and commercial counterpoint to the military and security aspects of the rebalance. By anchoring US growth prospects solidly in the Asia-Pacific zone, the TPP will reinforce US security guarantees by increasing the US stake in the region. Furthermore, by serving as an open club that could one day include the possibility of Chinese membership, the TPP diminishes the zero-sum nature of the rebalance.

For Obama’s Asian rebalance, the TPP could not come at a better time. Early in 2015, the administration suffered an embarrassing setback when European allies agreed to join the China-led Asian Infrastructure Investment Bank (AIIB) against the urging of Washington. Although the US likely over-
stated any threat posed by the AIIB to the current international economic architecture, the rebuke of other developed-country allies was interpreted as a sign of waning US influence in Asia. Successful completion of the TPP would reassert US economic influence in Asia and vastly overshadow the AIIB misstep.

For Japan, the deal reinforces the centrality of the US-Japan relationship not only in the security but also in the economic realm. Singapore’s doubts about the US commitment to the region would also be addressed. And for the Vietnamese, the TPP would serve as an important stepping stone for further deepening of the bilateral relationship, allowing the country to further diversify away from China. With China asserting an ever more aggressive presence regionally, the US role as a geopolitical balancer will remain of critical importance. The TPP would mark the most concrete step toward establishing the US commitment to maintain its role as a central player and balancer as Asia develops in the 21st century.

The TPP negotiation also reflects and strengthens the Asian rebalance. As China increases the frequency and intensity of its aggressive territorial moves, the TPP will boost Japan’s status as a potential counterweight for TPP countries in Asia. Countries in the region want to maintain positive relations with China, but also often hope to leverage the TPP to expand their economic, political, and security ties with Japan to balance and dilute Chinese influence. Japan, too, regards the TPP as a means to further solidify
its already close strategic relationship with the US and to strengthen its ability to cooperate with other TPP countries to address shared geopolitical concerns in Asia.

Over the long term, the TPP has real potential to preempt conflict. Expanding international commerce has contributed to the absence of interstate warfare in East Asia since 1979. The TPP alone will not guarantee peace in Asia; that will likewise depend on the success of Beijing’s own economic and political reforms. But if China were to one day join the TPP, further increasing its exposure to the US economy, that would raise the price—and therefore lessen the likelihood—of regional aggression.

Geoeconomic implications
Since World War II, the US has promoted free trade as a centerpiece of US foreign policy in order to boost global growth and avert conflict. Since then, trade liberalization has occurred mostly on a global scale through the General Agreement on Tariffs and Trade and the WTO, and during both Democratic and Republican administrations in the US. Yet the WTO liberalization pathway is effectively blocked by assertive emerging markets and a deadlocked consensus-based process, so the impetus has shifted to regional megadeals.

Multilateral deals with like-minded countries can lead to bigger liberalizations than bilateral accords, because the larger the economic impact the greater the pool of domestic supporters. Megadeals, at the same time, cut through the distorting overlap of bilateral agreements by creating single sets of rules. The deepening of EU integration and the creation of NAFTA were the first two initiatives along this track. The second wave comprises the TPP and the TTIP.

If the TPP succeeds, it will have a transformative impact on the world’s trading ecosystem. It will set new high watermarks on market access. It will address the disputes the WTO’s failed Doha Round could not resolve. And it will go beyond the WTO in addressing new trade-related behind-the-border issues such as government procurement, SOEs, and regulatory coherence.

The TPP will not remain static in terms of membership. Many countries, including Colombia, Costa Rica, Taiwan, and the Philippines, have already expressed strong interest or begun bilateral consultations on joining. The most important new member after TPP-12 completion will be South Korea, whose accession to the bloc will reverse a $2.8 billion decline in GDP from lost trade and allow the country to reap gains of more than $40 billion in 2025. South Korea already has a free trade deal with the US and will face a tough negotiation on market access with the Japanese. However, a political consensus in Seoul has emerged that missing out on the TPP is a mistake regardless of negative feelings toward the current Japanese leadership.

In the western hemisphere, the Pacific Alliance, a free trade deal involving Mexico, Peru, Chile, and Colombia (all but the last of which are TPP members), will be greatly strengthened. Other Central American countries such as Costa Rica and Panama will be more eager to gain the FDI and diversification that Pacific Alliance membership would bring, while Uruguay and Paraguay may also be tempted to join.

The BRICs’ trade strategy depended on what they perceived as leverage in the WTO system. They expected developed countries to give in so they could gain broader access to their dynamic
economies. But the TPP—and eventually the TTIP—participants will bypass them via the deep integration of these regional deals. This will leave outsiders to join later or urge TPP and TTIP countries back to the WTO for a global round on more favorable terms.

The TPP will set the standards and provide a new anchor for rules and norms. It will inject a race-to-the-top dynamic into the global trade arena as countries will pursue domestic reforms to secure TPP membership. Just as the prospect of WTO membership spurred domestic Russian and Chinese reforms, and as EU accession prompted reforms in former Warsaw Pact countries, so too will the promise of a TPP bid on the Pacific Rim. South American and South Asian countries, and most of all China, will orient domestic reforms around TPP chapters.

The successful conclusion of the TPP could confront China with difficult trade policy choices. On the one hand, leaders could orient China toward a long-term accession strategy, facilitated by movement on the US-China BIT and seeking a TPP back door through a China-Japan-South Korea trilateral FTA. China, alternatively, might work to enhance the Regional Comprehensive Economic Partnership (RCEP) concept with the aim of ultimately melding the two deals. Lastly, China could continue to pursue the WTO path in an effort to use the TPP to reinvigorate the broader multilateral trade agreements. Each comes with risks and tradeoffs, but in any event, China cannot afford to remain static.

The TPP’s passage will have a sizable impact on the trajectory of the RCEP. Two possible outcomes could emerge. First, the RCEP could fade away as the TPP becomes the regional centerpiece. Second, dilatory RCEP countries could increase their ambition and speed up the negotiation in order to mitigate effects from the TPP. Either scenario bodes well for regional integration. A similar dynamic may develop in South America, as Mercosur countries facing trade displacement from a resurgent Pacific Alliance and the TPP may be forced to boost liberalization offers to offset divergence.

The TPP, meanwhile, will substantially ease passage of the TTIP, the US-EU free trade deal. Because Obama already has fast-track authority, he or his successor could complete the TTIP with little risk of Congress torpedoing the agreement. To be clear, the TTIP is on a multi-year time horizon owing to difficult negotiations, existing trade integration between the US and EU that leaves only the thorniest issues to resolve, and Europe’s own internal struggles. But the TPP’s refocusing of US attention on Asia will exert added pressure on Europe to conclude a deal, and TPA clears the congressional pathway to implement it. A deal on the TPP would also boost momentum behind efforts to conclude the EU-Japan Economic Partnership Agreement, which both sides have pledged to work to conclude by the end of 2015.

Lastly, the TPP could even help restart WTO liberalization efforts. As trade diverts toward TPP members, developing countries in general and the BRICs in particular will feel pressure to lower their demands in WTO negotiations in order to not just realize potential gains but also stop losses.
If the TPP fails

Though the TPP is on balance likely to succeed, there are risks to full completion on both the domestic and international levels. The nature of any collapse would determine the depth of the loss for global liberalization and geostrategic efforts, which would be much greater than the simple dollar amounts of potential economic opportunity costs.

A failure of the TPP for any reason would have negative consequences, but the effect would probably be most damaging if the US political system forced its collapse. Because Obama has TPA, this could only occur in the unlikely event that Congress decided to reject a TPP deal after reviewing the text. In such a case, the US would be seen as incapable of committing to the Asia-Pacific, raising broader questions about US strategic credibility around the world in the face of rising isolationism and protectionism.

The US would lose considerable weight as the global champion of free trade and have less sway in shaping institutional reform of the global economic system. TPA legislation would no longer be a proxy for trade deal approval, lessening the willingness of other countries to negotiate with the US. The TTIP deal with the EU would likely die. And in Asia, the US-China BIT negotiations would risk fading away. China would be freer to drive regional trade norms to its advantage via the RCEP and on a bilateral basis, a project that is already well underway.

In Japan, the TPP’s collapse would undermine confidence among domestic and foreign businesses, investors, and consumers in Abe’s ability to make progress on structural reforms that promote competitiveness and innovation. Any significant erosion of belief in Abe’s commitment to shaking up the rigid status quo would cloud the outlook for more robust, long-term growth as well as prompt foreign firms to rethink FDI plans targeting Japan. Doubts about Abe’s political acumen would multiply, making him more vulnerable to challenges to his leadership. Lastly, concerns would grow that vested interests, large public debt, and demographic trends such as a low birth rate and rapid population aging will continue to weaken the competitiveness of Japanese industry and undermine Japan’s capacity to protect its economic, political, and security interests, especially in the face of a more powerful and assertive China.

In Vietnam, risks include creeping political complacency as the economy improves absent TPP-driven reforms. Though Dung would still generally be able to reach the easily obtainable goals of privatization and divestment to lighten bulky SOEs that created Vietnam’s economic crisis, improving economic conditions might have an inadvertent downside. Dung might have more difficulty leveraging political pressure to challenge vested interests in the top tier of management at SOEs to improve corporate governance if the economy emerges from its state of crisis. Though uncertainty about the extent of SOE reform will drag out beyond the conclusion and implementation of the TPP deal, the collapse of the TPP would remove an important tool that reform-minded Vietnamese leaders could use to justify their efforts to restructure management.

In North and South America, the US would lose much capacity to engage on trade. Any chance of updating NAFTA to reflect innovations and shifts in trade over the time since it was signed would be lost, and the Pacific Alliance would have trouble expanding. Mercosur countries would have even less of an incentive to deepen their relationship without the added pressure from the TPP as an alternative.
In a more severe downside scenario, geopolitics would also shift. US credibility in Asia would be shaken leading to more unstable regional dynamics. US allies including South Korea, Taiwan, Japan, and the Philippines might lose faith in their security guarantees, and either grow more willing to align more closely with China or feel cornered into acting out to independently establish their credibility. China, too, would doubt US commitments to the region and perhaps become emboldened on the security front. On the whole, the US-China relationship would develop a more zero-sum dynamic, because the elimination of the rebalancing’s economic component would leave only the security element.