Testimony before the United States House Committee on Foreign Affairs, Subcommittee on Asia and the Pacific, Hearing on China's Rise: The Strategic Impact of Its Economic and Military Growth

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Chairman Salmon, Ranking Member Sherman, members, thank you for inviting me to testify on this pivotal topic: the geo-economic and geo-political significance of China's rapid development and the U.S. strategic response, particularly as it pertains to the Trans-Pacific Partnership agreement.

I would like to begin on points of agreement between proponents: it matters a lot who gets to write the rules for how our economy and the international economy work. Last week's historic vote by you and your colleagues on Trade Promotion Authority and Trade Adjustment Assistance showed how much the rules matter. What this said is that something is broken in the ways the United States makes trade rules: the dysfunction of the implicit agreement between Congress and the President—and his delegated ambassador as United States Trade Representative—in how Constitutional division of authorities to make international agreements will govern in practice.

When the rules matter this much, we should take the time to get them right, rather than bull-doze non-transparent new rules through Congress. What we know about the agreement—from Wikileaks, and from conversations with negotiators of more open TPP countries—is that the Trans-Pacific Partnership (TPP) has less to do with freeing trade, creating jobs, raising wages, or rebalancing geo-politics than it does with rewriting the rules of global trade and investment to favor big businesses at the expense of almost everyone else in society.[1]

These rules do not embody economic principles of open competition so much as the preferences of industry lobbyists that had the best seats at the U.S. Trade Representative's table. The outcome is an agreement that fails to address America's economic needs and geostrategic goals. Legitimate concerns have been raised on the left, right, and center of the American political debate, only to be dismissed by conventional wisdom as protectionist, old-fashioned, or naive to the ways of the world. But as Larry Summers wrote in the *Washington Post*, it's time to take these concerns seriously.[2]

Problems with current U.S. model for trade policy do not end with TPP. A multitude of agreements are underway under the same basic template--from a parallel mega-regional agreement with the European Union, to a multilateral agreement on trade in services (TISA), to a bilateral investment treaty with China itself and other countries that will all be critical to the U.S. economic future. They are critical to whether we grow with broadly shared prosperity or continue down the path of an economy producing high and rising inequality, and low economic opportunity.

Proponents of TPP are asking us to believe we can achieve the high road outcomes from a USTR so captured by special interests. But unless Congress acts to change the rules on how the United States government negotiates international economic agreements, we can expect the same confrontational and uncertain political outcomes, rather than a cooperative, inclusive approach to setting national economic priorities.

I will make two points today:

1. The most fundamental element of national security is a strong national economy, and TPP would weaken our economic base, leave us more unequal, and reinforce the global race to the bottom in social, environmental, and commercial standards and taxation.

2. TPP fails the geostrategic rationale for checking China's rise.

On the first point, the most generous models predicting TPP's economic impact claim it would raise U.S. GDP by $88 billion (in today's prices) by 2025.[3] This amount is less than the rounding error when the Department of Commerce calculates GDP. If you each picked an infrastructure project in your district, together you would create a bigger growth impact in the next year than TPP would have ten years from now.

The United States ranks among the highest of the advanced economy countries in inequality, and among the lowest in terms of upward economic mobility. TPP will lead to higher inequality--adjustment to new terms of trade will focus job and small business elimination in more labor-intensive industries—not just manufacturing, but in services of increasingly higher skill—faster than trade creates them in less labor-intensive export-expanding industries. Recent research by MIT economists Daron Acemoglu, David Autor, and co-authors shows that such import shocks decimate local economies, causing higher unemployment, slower wage growth, and straining social expenditures and tax revenues. Trade with China in particular, they estimate, cost the U.S. economy 2 to 2.4 million jobs over the course of the 2000s.[4]

TPP goes far beyond mere tariffs and trade. All sides agree TPP's most significant provisions address "behind the border" measures—not what happens between countries, but how the economic rules will work within countries.

To highlight two major issues, first is TPP's investor–state dispute settlement mechanism (ISDS). Here, progressives like Senator Elizabeth Warren and a Nobel prize-winning economist Joseph Stiglitz are joined by the likes of Cato Institute and *The Economist* magazine in raising concerns that ISDS serves to empower global businesses against public regulation.[5] Understandably, global businesses would like assurance against expropriation and discriminatory treatment where rule of law is underdeveloped. But they can already buy private insurance against such risks. That USTR also insists on ISDS in an agreement with Europe, where no one questions legal standards, reveals the lie that this is about protecting investor rights, rather than expanding and subsidizing them.

The distortions created by this change in the rules provide a privilege for foreign investors not accessible to domestic investors in any TPP market, and works against developing country partners growing their own institutions and organically raising standards through more open, democratic policymaking. The combined result is to further incentive production to move offshore.

We also have to be clear about the dangers of TPP's expansive intellectual property protections. Economic research is clear that patents do not increase innovation or growth. Rather, they serve to raise consumer prices and restrain competition. The agreement reportedly will allow "ever-greening" of drug patents and aim for more stringent exclusivity for biosimilar medicines than even President Obama's budget proposed, meaning less access to medicines and slower development of new ones in TPP members and in third party countries. For the United States, this outcome would mean more national income will be spent on health care—through private spending and public programs. This is not a question of guns versus butter, but of guns, butter, or life-changing medicines.

On my second major point, that TPP fails the geostrategic rationale for checking China's rise, proponents argue TPP is needed to buttress Asia-Pacific allies with an implicit economic ring-fence around China's rising power and influence. This is a Cold War containment strategy, but in the 21st century the United States is no longer the epicenter of the world economy. And the strategy violates a seemingly forgotten long-standing tenet of the open world trading system, built painstakingly under U.S. leadership in the postwar years: the quest for peaceful foreign relations would be built on the principle of not excluding countries from the benefit of economic relations—the opposite of what TPP, and the Trans-Atlantic Trade and Investment Partnership would do.

A strategic agreement countering China's rising influence, to be effective, requires two things: First, it must truly set high standards for international trade and investment; second, it must largely exclude China from the benefits, diverting investment and trade to TPP countries, thereby enticing China to rise to TPP standards. TPP does neither. China's economic transformation under authoritarian capitalism, it's ongoing non-market economic structure, and its expanding geopolitical influence pose real foreign and economic challenges for the United States and for the future of open societies, but TPP doesn't answer to any of them.

On the first question, the level of standards, TPP clearly does not make any economically meaningful advances over the status quo. Although the agreement reportedly would establish well-sounding obligations on labor rights, environmental protection, and accountability for state-owned enterprises, TPP provides no credible mechanism to enforce these standards.

The lose-lose scenarios created by non-credible enforcement mechanisms are best illustrated in the case of Guatemala. In April 2008, Guatemalan workers first filed complaint of systemic labor abuses with the U.S. Department of Labor, as established by the US-Central American Free Trade Agreement; it took the USTR until December 2014 to open a formal dispute settlement case, and a ruling is still far off. Other recent experiences with partner countries Honduras and Colombia show no better results of improved practices or even an end to the rampant murders of free trade union members. This is the worst of both worlds: U.S. workers and businesses still face race-to-the-bottom competition, while global businesses and developing country governments face little pressure to improve conditions. No one has yet to give a clear answer to how TPP will effect free labor standards in one-party state Vietnam, or deter human trafficking of labor in Malaysia or Mexico?

This toothless model of enforcement for things other than investment and commercial disputes—and the fact that the agreement will not discipline currency manipulation in the Asia-Pacific region show that TPP does not set standards at a level that would pose meaningful constraints on China's economic behavior.

On the second question, TPP cannot feasibly exclude China from the benefits of the TPP bloc. In fact, Chinese officials and technocrats are as enthusiastic about TPP as any business lobbyist in Washington. That's because the 1 percent in both countries stand to gain substantially from a deal allowing both to expand supply chains into lower-cost developing Asia. TPP will not lock-in a U.S. export advantage in the region so much as a platform for U.S. and Chinese companies that want to offshore production to TPP member countries. This loophole is found in TPP's "Rules of Origin," or the percentage of a product's value must be created in the TPP member country in order to qualify for preferential access to U.S. markets.

China is already more integrated with TPP countries than the United States. China's total trade (exports plus imports) with non-Nafta TPP partners is nearly double ours--$780 billion in 2014 for China to our $423 billion.[6] Beijing is now incentivizing Chinese enterprises in a strategy of "going out"—expanding China's global footprint and brand recognition through massive foreign direct investment.

Deep and growing integration with TPP countries will mean that Chinese producers can enjoy the agreement's benefits—either by investing in or trading Chinese-produced content through TPP countries, without reciprocating to TPP's preferential terms. How big an economy is and its geographical proximity to others—the "gravitational factors"—matter much more for international trade patterns than do agreements like TPP. China's economy will be bigger, grow faster, and be geographically and culturally closer to Asia-Pacific countries no matter what we do.

What's more, TPP offers negligible counterbalance to the soft power China is earning in the region with its efforts to develop new models of multilateral infrastructure development financing. Here, America's own unforced errors in foreign economic relations—from Congress's failure to enact internationally negotiated IMF reforms, to this administration's diplomatic debacle in their miscalculated strategy of strong-arming allies into a global boycott of China's efforts to advance multilateral development finance institutions with the Asian Infrastructure Investment Bank and other projects. This U.S. strategic choice actually lost us an opportunity to write the economic rules with China, instead the strategy left us isolated from the international community and left China to write the rules of these multilateral institutions without us.

When this is how we treat our friends, it's no wonder the United States has a reputation problem in the region. To illustrate the challenge, consider that Chinese officials and scholars routinely raise the Opium War and 1842 Treaty of Nanjing in conversations on trade and investment relations; they named their regional trade development initiative the "New Silk Road Initiative"—this is an area of the world where reputation holds long historical memory. Between the new BRICs bank, the Asian Infrastructure Investment Bank, and China's Silk Road investment initiatives, China is committing $300 billion of capital investment, and buying untold foreign influence. TPP simply does not match the same return on investment on the political capital we have spent pressing our partners to ignore the same concerns that make trade such a contentious political issue in the United States.

There is a further lesson here: America's economic future is tied more to the choices we make in the rules of our own economy rather than joining agreements. This Congress has been reluctant to invest in our own infrastructure. China's leaders not only recognize the growth value from investing in their own economy, but in helping other countries develop in ways that create mutually-reinforcing trade and growth benefits for China. This is what it means to treat countries like true partners rather than geopolitical pawns.

Conclusion

Strengthening international relationships is essential for ongoing U.S. leadership in the world—be it economic, political, or cultural. No American should relish a failure to build deeper, more open relations with foreign partners, nor should we retreat from trying. But getting to a deal that serves more than the narrow interests of powerful corporations, their CEOs and shareholders will require Americans be willing to walk away from the agreement we have now, and for Congress to change how it exercises input and oversight over USTR's negotiating priorities.

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[1] Full disclosure: I have been briefed privately, off the record on a number of occasions by USTR officials, but am similarly prevented from revealing the substance of those discussions.
[2] Larry Summers, "Rescuing the free-trade deals," *Washington Post*, June 14, 2015, available at http://www.washingtonpost.com/opinions/rescuing-the-free-trade-deals/2015/06/14/f10d82c2-1119-11e5-9726-49d6fa26a8c6_story.html.
[3] Author's analysis of http://www.iie.com/publications/pb/pb12-16.pdf.
[4] Daron Acemoglu, David Autor, David Dorn, Gordon H. Hanson, Brendan Price , 2014, "Import Competition and the Great U.S. Employment Sag of the 2000s," *NBER Working Paper No. 20395*, available at http://www.nber.org/papers/w20395.

[5] See *Economist*, "The Arbitration Game," October 11, 2104, available at http://www.economist.com/news/finance-and-economics/21623756-governments-are-souring-treaties-protect-foreign-investors-arbitration; Simon Lester, "Does Investor State Dispute Settlement Need Reform?" *Cato Unbound: A Journal of Debate*, May 11, 2015, available at http://www.cato-unbound.org/2015/05/11/simon-lester/does-investor-state-dispute-settlement-need-reform; Joseph Stiglitz, "Where progressives and conservatives agree on trade: Current investor-state dispute settlement model is bad for the United States," Letter sent to Congressional leaders, May 18, 2015, available at http://www.rooseveltinstitute.org/joseph-stiglitz-and-trans-pacific-partnership-tpp.
[6] Analysis of United Nations Comtrade Database data, available at http://comtrade.un.org/data/.