Northern Trust

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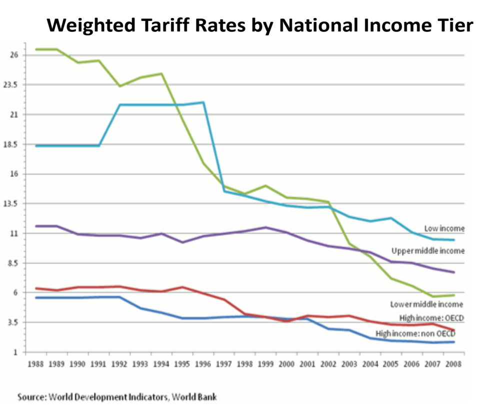
- **Trying to Avoid a Bad Trade**
- **New Trade Deals Are Dying on the Vine**

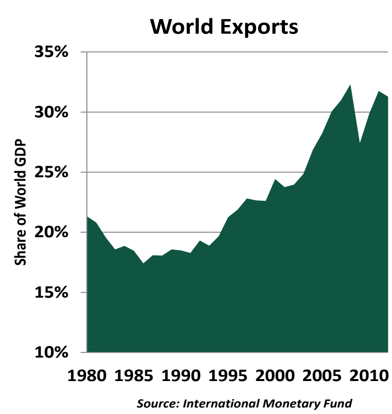
I collected baseball cards when I was a kid, and I was intent on getting a complete set every year. There always seemed to be one or two obscure players who were exceptionally difficult to acquire; I suspect the producers purposely ran fewer copies of certain cards to keep kids buying more and more packs.

Since I had a very limited budget, I tried to reach my goal by swapping with others. But this proved a costly strategy; I gave up the cards of a dozen Hall of Famers for the ones I needed (which depicted reserve pitchers who barely played). As the cards I had given away rose in value over time, my attitude toward trade darkened.

In the present day, there are an increasing number of people around the world whose attitudes toward trade are darkening. With economic growth sluggish and uneven in many countries, international commerce has come to be seen as a hindrance, not a help. Politicians around the world seem anxious to revisit not just trade agreements and trade relationships, but also the basic question of whether trade is a good thing.

The benefits of trade were highlighted eloquently 240 years ago in Adam Smith's *The Wealth of Nations*. Free exchange allows specialization that advances economic progress and creates wealth. But while commerce within countries is relatively uncontroversial, things become considerably more complicated when transactions cross borders.





International trade often occurs out of necessity. Not all nations have access to the basic commodities they need, like petroleum; as a result, some level of trade is not just desirable, but essential. But where countries have overlapping capabilities, there is a natural tendency for governments to be protective of domestic producers. Tariffs and quotas are the most visible methods employed for this purpose, but more subtle means such as domestic content requirements, subsidies for home companies and export finance banks are also common.

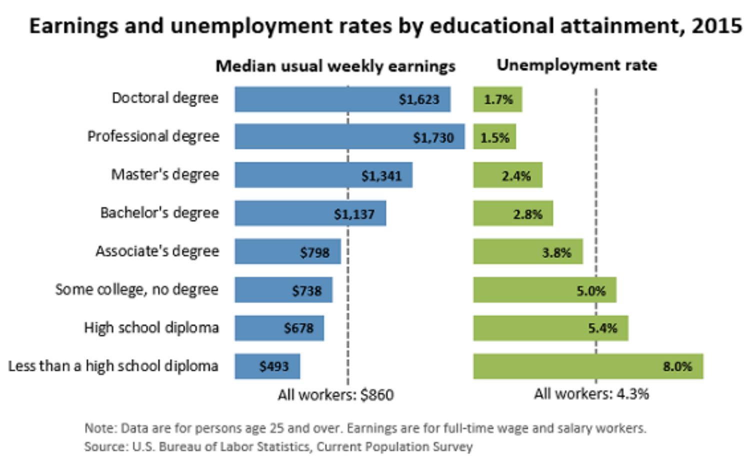
Beginning about a generation ago, efforts were initiated to lower these barriers. Economic theory was clear: what worked within markets could be even more powerful and positive if extended across markets. International agents like the World Trade Organization (WTO) began promoting standards for the conduct of trade among its members, and regional trade pacts became more common. Parties to these treaties agreed to open their industries to imports and foreign competition in the hope of creating reciprocal opportunities for domestic companies to export.

Trade's gains are subtle, but the losses it creates are overt.

A review of trade's advantages seems in order. Imports bring greater choice and lower prices; these benefits accrue to all, but more substantially to those families who are working hardest to make ends meet. Greater opportunities for export create new employment. Global competition sharpens domestic firms, leading them to be more efficient. Trade revenue earned by emerging markets reduces poverty and puts them in a better position to purchase more products from developed markets.

Estimating the costs and benefits of trade is exceptionally difficult. The course of economic activity is affected by a host of factors, and it is impossible to observe how events would have unfolded in the absence of trade arrangements. Studies that attempt to isolate the impacts are often colored by the bias of their authors. A good summary of the different perspectives on the North American Free Trade Agreement (NAFTA), which has been frequently discussed in the run-up to the U.S. presidential election, can be found here.

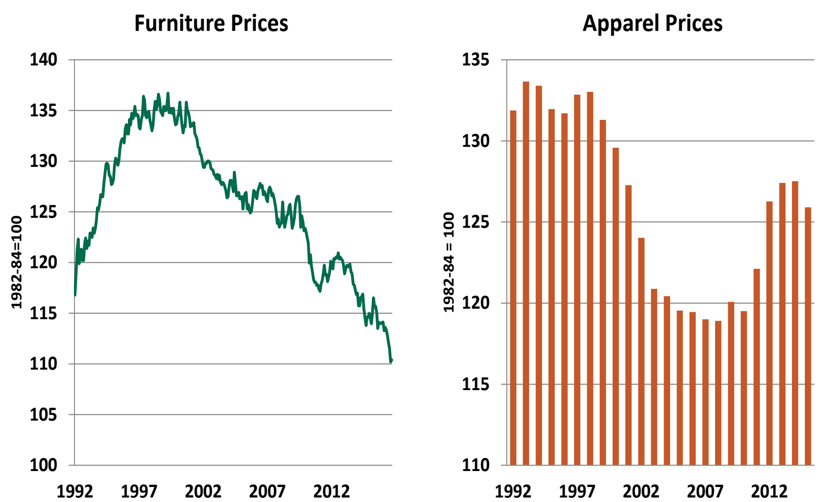
The benefits of trade can be subtle, but the costs are more readily apparent. Industries that had been protected often recede once exposed, leaving workers displaced and regions impoverished. While those enjoying the upsides of free trade might scarcely notice it, those on the other side of the bargain cannot escape it.



Around the world, workers with only modest levels of education are finding it more difficult to sustain themselves. Even though globalization is only one contributor to their struggle (technology has also played a heavy hand), workers' frustration with trade and immigration has provided kindling for the spread of populism. The leaders of these movements have advanced, in part, on a pledge to arrest the flow of goods and people from overseas.

To address the dislocations created by trade arrangements, countries often provide help to those affected. In the United States, Trade Adjustment Assistance (TAA) has been an important component of major trade agreements for almost forty years. TAA supplements income, facilitates re-training, and helps with job searches. But studies have found those covered by TAA have lower rates of re-employment than workers who do not. As a result, some in the U.S. Congress are seeking significant reforms to the program, while others are trying to end it.

Much of the attention during the present U.S. presidential campaign has been focused on NAFTA. This isn't the first time: during the 1992 campaign, Ross Perot made a major issue of the "giant sucking sound" of jobs moving from the U.S. to Mexico. In the years since, however, NAFTA has produced the outcomes its proponents anticipated: lower prices and expanded opportunities for each of the countries involved.



Source: Haver Analytics

China's entry into the WTO has had a huge impact on global trade flows.

The second target of popular anxiety in the trade space has been the behavior of China. The penetration of Chinese products increased dramatically after it entered the WTO in 2001. There have been frequent concerns, many of them quite valid, about Chinese trade practices. But it also bears mentioning that Chinese imports have grown dramatically in the years since, opening a vast (and increasingly wealthy) market to foreign providers.

Most economists would say that closing the borders would have the opposite of the intended effect: jobs would be lost and prices would rise. It is worth noting that export earnings from trading partners are often the source of financing for domestic government debt; if those capital sources are diminished, that debt might become more difficult to sustain.

Yet trade has become such a toxic subject that it is hard to find candidates who are willing to express public support for it. (Even those who have favored free trade in the past are reversing course.) This is partly the product of campaign-year expedience. But while the abrogation of NAFTA and other existing agreements seems unlikely, it seems equally unlikely that new trade pacts will receive much of a fair hearing.

Closing the borders would lock in bad outcomes.

There are two prominent opportunities that may go unrealized after years of careful cultivation. These are discussed below. It isn't just the growing antipathy in the U.S.; attitudes toward trade are even more negative in many parts of Europe. The struggles of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada (just completed after seven years of negotiations) illustrate how difficult it is to advance the cause of global commerce in the current environment. This experience bodes ill for the upcoming Brexit negotiations.

In sum, the trade gains achieved during the last generation face significant risk of reversal in the coming years. Retreat would be bad news for global growth and global markets.

After I departed for college, my mother discarded my baseball collection in an effort to purge my bedroom of clutter. Little did she know that the contents of those shoeboxes could have paid for a good portion of my undergraduate education. Then, as now, it would be tragic to discard something valuable out of misunderstanding.

The Devil Is in the Details

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As we approach the end of the acrimonious election campaign in the United States (none too soon), it is increasingly clear that there is little political appetite for multilateral trade agreements such as the Trans-Pacific Partnership (TPP) or the Transatlantic Trade and Investment Partnership (TTIP). The former is a proposed trade agreement between nations on the Pacific Rim, including the United States, Canada, Mexico, Japan, Australia and some smaller South East Asian economies, while the latter is being negotiated between the United States and the European Union.

Popular discourse on trade has centered largely on jobs, and understandably so. The fear of losing employment to locales with lower costs and more relaxed environmental, safety, and labor regulations is not new; but it has reached a high pitch during the sluggish recovery from the 2008-09 recession. Only immigration is a larger source of political discontent in the developed world.

But when you look at the details of, such fears appear to be either misplaced or overstated. Both structures were borne out of the collapse of the Doha round of negotiations at the WTO in 2008. The idea has been to provide regional alternatives to the global agreements that have been increasingly difficult to reach. Neither of these deals is likely to produce the sort of seismic industrial changes their opponents fear. Tariff barriers between most of the participating countries are generally low to begin with, and any impact of freer trade is likely to be fairly marginal.

On the surface, the focus of TPP and TTIP is on enabling investment, improving governance, streamlining regulations, strengthening intellectual property rights (IPR) and leveling labor and environmental standards. These sound like reasonable aims, but critics concerned about the equity of trade have found plenty to be unhappy with.

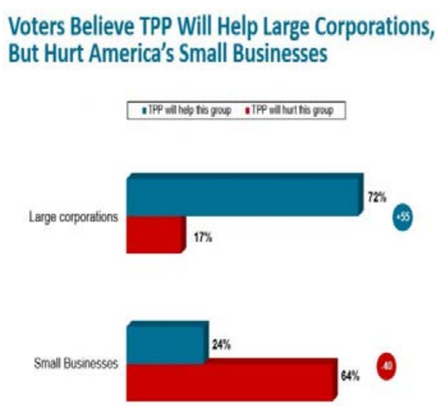
In policy circles, the key concerns about TPP and TTIP center on the strength of IPR protection, removal of state preferences, and Investor-State Dispute Settlement (ISDS). IPR protection is of particular relevance for the pharmaceutical sector due to the fear that tighter IPR would keep medicine costs high. Americans will spend an estimated $430 billion on prescription drugs in 2016, an estimated $360 billion of which will go toward the financing of research. (In the absence of patents, this cost would come down to an estimated $60-80 billion.) TPP would provide additional protection for pharmaceutical patents and extend it to signatories of the treaty. This might drive up their medical costs substantially.

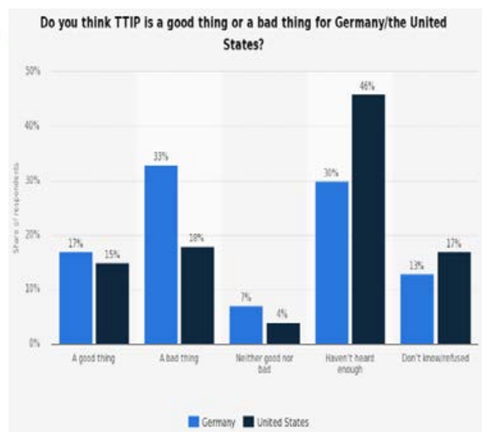
Furthermore, many countries have policies in place that favor domestic or state-owned enterprises over foreign players. Both TPP and TTIP would outlaw them, limiting the ability of governments to have a more activist industrial policy.

Objections to TTIP and TPP boil down to a perceived loss of sovereignty.

Finally, there is the controversial ISDS, which allows foreign investors to sue governments. These cases are to be adjudicated by three (non-government) lawyers serving as judges. Even though structures like this are currently in force in a number of trade agreements, their use has been fairly limited until recently. The basic logic is to prevent appropriation of assets or mistreatment by foreign governments.

But given that most of the countries negotiating these agreements have fairly well-established rule of law, ISDS is seen to be unnecessary and loaded in the favor of corporations. In fact, ISDS was one of the contentious issues in the CETA trade agreement negotiations that almost collapsed recently.





Sources: International Business Times, Bertelsman Siftung, YouGov

These subtleties may not generate the kind of public opprobrium that job losses do, but as they are revealed, they feed into the skepticism many people have over whether trade is making them better off.

In one way or the other, these issues all come down to sovereignty. Whether it's the inability to set the standard of regulations, the existence of fewer preferences for domestic enterprises, or the prospect of foreign companies tying up governments in litigation, the terms of the proposed trade deals are seen to be impinging on the freedom of national governments. This, combined with anxiety over whether the terms are in the public interest, creates a difficult road to ratification.