Expert paper #5

THE ECONOMICS OF THE TPPA

Barry Coates, Rod Oram, Dr Geoff Bertram and Professor Tim Hazledine

Key Points: modelling the benefits of the TPPA; key issues for agriculture and trade rules; implications for value chains; the economic implications of regulatory restraints; a flawed model for the 21st Century agreement.

January 2016

Funding support from the New Zealand Law Foundation.

The views expressed should not be attributed to the NZ Law Foundation.

Negotiations for the Trans-Pacific Partnership Agreement (TPPA) among twelve negotiating countries - Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States and Vietnam - were concluded in Atlanta, USA on 5 October 2015. The text was released on 5 November 2015. The agreement has 30 chapters and many annexes, with parties also adopting bilateral side-letters. They are expected to sign the TPPA on 4 February 2016 in New Zealand, which is the formal depositary. Each party to the negotiations must complete its own constitutional processes and requirements before it can take steps to adopt the agreement. The TPPA will come into force within two years if all original signatories notify that they have completed their domestic processes, or after 2 years and 3 months if at least six of them, including the US and Japan and several other large countries, have done so. This research paper is part of a series of expert peer-reviewed analyses of different aspects of the text.

THE ECONOMICS OF THE TPPA

CONTENTS

KEY POINTS

- Modelling of the economic benefits of the TPPA for New Zealand, commissioned by the Ministry of Foreign Affairs and Trade (MFAT), predicts an increase in GDP of 0.9% by 2030 or $2.7 billion.
- These benefits are modest - extrapolating from current growth rates, GDP would increase by 47% by 2030 without the TPPA or 47.9% with the TPPA.
- Estimates of the gains from tariff reductions are less than a quarter of the projected benefits according to the modelling, and are exaggerated.
- Most of the projected benefits result from reducing Non-Tariff Barriers (NTBs) – these rely on inadequate information that neither identifies the NTBs that would be reduced by the TPPA nor distinguishes between protectionist measures and legitimate government regulation.
- According to recent modelling, the TPPA is projected to result in a reduction in employment and an increase in income inequality for New Zealand.
- The government has not included the costs that are likely to result from the TPPA in its analysis - these are likely to be significant, and may outweigh the economic benefits.
- A comprehensive and objective cost-benefit analysis should be undertaken before signing or ratifying the TPPA.
- Gains for agricultural producers are small compared to fluctuations in commodity prices and exchange rates.
- Restrictions on labelling through the TPPA's Sanitary and Phytosanitary Measures may restrict opportunities for New Zealand food exporters to build a high quality, differentiated market position.
- Significant tariff barriers remain in the dairy sectors of Japan, Canada and the US - these are likely to be 'locked in' under the TPPA and more difficult to remove in future.
- Regional trade agreements such as the TPPA will undermine negotiations on agriculture in the World Trade Organisation, which is only realistic forum to reduce the massive agricultural subsidies that distort agricultural markets.
- The TPPA will both help and hinder New Zealand's ambitions to add value to our raw materials and commodities, and climb up value chains – more analysis is required.
- The benefits of the TPPA are likely to be asymmetric - the TPPA is favourable to the business model and practices of US multinationals and may exacerbate the disadvantages of New Zealand's size and remoteness.
- The potential threat from cases under the TPPA's Investor State Dispute Settlement is likely to create a chilling effect on New Zealand governments' laws and policies.
- The delay in implementing plain packaging regulations for cigarettes in New Zealand is a current example of regulatory chill; regulation in sectors such as banking, energy, climate change, transport, environmental protection and mining may be subject to threat from potential ISDS cases.
- Potential compensation payments or settlements could far outweigh the limited economic benefits from the TPPA; even if cases are successfully defended, the legal costs are onerous.

- The TPPA's coverage is far from comprehensive and its US-centric rules on intellectual property, services and dispute settlement mean that it is unlikely to be the model adopted by China or the EU.
- The TPPA would limit governments' ability to innovate and address deeply entrenched inequalities in health, education and income, and exacerbate rapidly escalating problems such as environmental degradation and climate change. The TPPA falls short of being "a trade agreement for the 21st Century" as its proponents claim.

Modelling of Economic Benefits for New Zealand

The TPPA has been justified to the public on the basis of its economic benefits, although political factors such as New Zealand's relationship with the US are also cited as important. This research paper analyses the economic benefits projected from the TPPA, looking particularly at economic modelling which was commissioned by the government.

The government has used modelling to derive estimates of the economic benefit for New Zealand and estimated an increase in real GDP of 0.9% by 2030 or $2.7 billion annually.[1] The increase is modest. A continuation of currently forecast levels of growth[2] would mean that NZ GDP would be 47% higher by 2030 without TPPA, versus 47.9% with TPPA. This projected economic benefit has usually been cited as the main justification for New Zealand's participation in the TPPA.[3]

The estimates are based on modelling undertaken prior to conclusion of the negotiations, using a Computable General Equilibrium (CGE) model.[4] A commentary on the modelling[5] concluded that, while CGE models are commonly used to model trade policy changes, their validity depends on crude assumptions about how real-world markets function and their results are very sensitive to errors in these assumptions.

The commentary found that the standard of documentation of the modelling is dreadfully inadequate – just 20 pages of text in the published report. The authors should have chosen, or been asked to present, a much weightier and more detailed account of every facet of the data, assumptions, modelling and results.

1 MFAT "*Economic Modelling on Estimated Effect of TPP on New Zealand Economy*" TPP Talk http://www.tpp.mfat.govt.nz/assets/docs/TPP%20-%20CGE%20Analysis%20of%20Impact%20on%20New%20Zealand,%20explanatory%20cover%20note.pdf

2 Medium term forecast 2.6% per annum http://www.treasury.govt.nz/budget/forecasts/befu2015/009.htm

3 eg. Nevil Gibson "*TPP: Groser spells out the benefits for NZ*" NBR, 6 October 2015 http://www.nbr.co.nz/article/tpp-groser-spells-pout-benefits-nz-ng-179695

4 Anna Strutt, Peter Minor and Allan Rae, "*A Dynamic Computable General Equilibrium (CGE) Analysis of the Trans-Pacific Partnership Agreement: Potential Impacts on the New Zealand Economy*" http://tpp.mfat.govt.nz/assets/docs/TPP%20-%20CGE%20Analysis%20of%20Impact%20on%20New%20Zealand,%20report.pdf

5 Tim Hazledine, *No More than a Case of Beer? TPP trade liberalisation benefits for New Zealand,* University of Auckland, December 2, 2015.
https://tpplegal.files.wordpress.com/2016/01/hazledine-on-trade-models-021215.pdf

This latest modelling of benefits from the TPPA followed an earlier analysis that projected $4.5 billion in benefits to New Zealand.[6] A critique of that modelling noted that the model had been positioned as a net benefit analysis, including the assumed benefits from wide-ranging TPPA provisions but excluding any downsides in terms of direct or indirect costs, the loss of national sovereignty and the loss of regulatory autonomy.[7]

(i) Tariff reductions

The justification for the TPPA is generally made through citing the tariff savings for exporters. It is therefore striking that a relatively small fraction (23%) of the projected benefit in the government's latest analysis of the TPPA results from tariff reductions. Even this benefit is over-stated. In particular, there is confusion over what is meant by 'tariff reductions'. MFAT has estimated that there will be $259 million in reduced tariffs by 2030, the date by which all tariff reductions will have been implemented.[8] This figure of $259 million has been portrayed by the government as tariff savings for New Zealand exporters and treated as economic benefit for New Zealand in the modelling.

However, it is extremely unlikely that all of the gain from tariff reductions will accrue to New Zealand exporters. The commentary addresses this point.[9] In an extreme case, if tariff reductions were to be captured entirely by the supply chain, including the producers, there would be no change in price and no consumer benefit in the liberalising countries. This is not generally the way that trade agreements are justified to consumers. At the other extreme, in perfectly competitive markets all of the benefit would be passed on through the supply chain and reflected in a lower price to consumers and there would be an increase in demand. This is the assumption used in the modelling exercise.

The commentary observes that real-world conditions of demand, costs, product differentiation and competition are likely to vary the burden of the tariff between the extremes described. Most of New Zealand's agricultural exports are commodities and exporters are in a relatively weak position in the supply chain, so tariff reductions are more likely to increase the margins of powerful actors in the supply chain (typically processors or retailers). If an optimistic view was taken that half of the benefit from tariff reductions would accrue to New Zealand exporters, the value of the tariff reductions in 2030 would amount to $130 million or 0.05% of current GDP, equivalent to around $40 per New Zealander per year.

6 Peter Petri, Michael Plummer and Fan Zhai "*The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment"* 2012 Peterson Institute for International Economics.

7 Geoff Bertram and Simon Terry, "*Economic Gains and Costs from the TPP"*, February 2014, Sustainability Council

8 MFAT "Economic Modelling..." op cit. In fact, some of the tariff and quota phase in periods extend to 30 years, after the TPA comes into force. This would be 2047 at the earliest.

9 Hazledine, pages 6-7 op cit.
https://tpplegal.files.wordpress.com/2016/01/hazledine-on-trade-models-021215.pdf

(ii) Trade facilitation

The second area of economic benefit in modelling is trade facilitation. The modelling estimates that $374 million[10] of economic benefit would result from improved trade facilitation measures. Customs clearing times are assumed to be reduced by 25% across the 12 TPP countries.[11] Aside from this broad assumption, there is no breakdown of the current inefficiencies and barriers, where and how the efficiencies are likely to be realised, or how the TPPA's provisions would result in such reductions.

Since the larger TPP parties are OECD countries with relatively efficient customs systems, it is likely that the scope for cost savings are not large. Otherwise, they would have been realised already, either autonomously in the drive for cost savings, or through the many trade agreements already containing trade facilitation commitments. Quarantine and customs procedures play an important role in the economy and there are potential risks from biosecurity breaches or imports of illegal goods that may result from streamlining customs procedures. What may look like a 'barrier to trade' to trade negotiators is often a regulation that reduces risks to New Zealand's vitally important agricultural sector, its natural environment and its conservation estate.

The modelling assumes that benefits from trade facilitation will be gained from this agreement between twelve countries. However, bilateral and plurilateral trade agreements may facilitate trade in some ways but they introduce new complexities in the form of rules of origin. Further, the modelling assumes that there are benefits without any additional costs. Significant improvements in customs processes require investment, for example in automated goods handling and information processes. The modelling does not include costs of investment that may be required to achieve efficiencies.

Nor is there any analysis of attribution to the TPPA specifically, outlining how the TPPA would create additional benefits beyond other trade agreements (eg. WTO Trade Facilitation Agreement, North American Free Trade Agreement (NAFTA), ASEAN-Australia-New Zealand Trade Agreement, and a range of bilateral and regional trade agreements that have trade facilitation provisions). The Australian Productivity Commission's analysis of the US-Australia FTA noted that many of the trade facilitation provisions of bilateral and regional trade agreements are similar, and most reflect the provisions of the WTO Trade Facilitation Agreement.[12] An assumption that a reduction of the magnitude of 25% would be achieved by the TPPA alone suggests that there is probably double-counting in reductions across the many different agreements.

Without further details of what the trade facilitation benefits are likely to be, how they can be achieved (and the costs of doing so), how cost savings are balanced with risk management, and how the TPPA will provide benefits beyond existing agreements, it is difficult to accept the estimate of gains to New Zealand of over $450 million per year (in current terms) as credible.

10 NZ$ in 2007 real terms

11 Strutt et al, Appendix 5, Page xviii, op cit.

12 Australian Government Productivity Commission *"Bilateral and Regional Trade Agreements"* November 2010 (p.71) http://www.pc.gov.au/inquiries/completed/trade-agreements/report/trade-agreements-report.pdf

(iii) Non-Tariff Barriers

By far the largest portion of the benefit from the TPPA for New Zealand, according to the modelling commissioned by MFAT, comes from removal of so-called Non-Tariff Barriers (NTBs). The government's analysis estimated that reducing NTBs would account for $1.7 billion of the $2.7 billion estimate for gains from the TPPA.[13] The modelling is not specific about the types of NTBs that exist amongst the TPPA countries, aside from the definition that they are 'measures that are discriminatory and are for the purposes of restricting trade'.[14] There is no adequate explanation about which countries maintain these barriers, how they are distinguished from legitimate Non-Tariff Measures (that are not for the purposes of restricting trade), what proportion of NTBs would be removed, what provisions in the TPPA would remove them or what the risks would be to societies as a result of their removal.

Modelling the benefit from reductions in NTBs pushes economic theory into controversial and untested territory. The Peterson Institute modelling of the TPPA in 2012[15] also included NTBs in their modelling of the benefits. A critique of that modelling questioned the validity of translating measures to enforce copyright and intellectual property rights into simple cost reductions that would increase trade in services[16]. Provisions that allow foreign investors to challenge government regulations or to reduce regulation of banks are also counted as trade-promoting cost reductions. Such methodologies are contested, speculative and unsubstantiated.[17]

There is considerable debate amongst TPP countries about what are legitimate measures to protect the public interest, such as standards on food safety, labelling and environmental protection, as opposed to discriminatory and protectionist barriers. Although the TPPA might remove some perceived NTBs, the economic gains for exporters or foreign investors may be balanced by costs to others in society. The removal of measures such as the requirement to label genetically modified organisms in food would create a net benefit in the modelling analysis, but it would not be regarded as a net benefit to New Zealand consumers. Similarly, removal of regulations on the finance sector, and opportunities for foreign banks and financial corporations to challenge New Zealand's laws, may be regarded as a benefit in modelling NTBs, but risks financial costs that are far higher, as New Zealand savers and investors discovered to their cost in the collapse of finance companies and the 2007-8 Global Financial Crisis.

An analysis of WTO trade disputes for the largest TPPA economies, US and Japan, for 2008-2013 shows 22 disputes against the US related to non-tariff trade measures, mainly for safeguards (anti-

---

13 MFAT "Economic Modelling..." Page 2, op cit.

14 Strutt et al, footnote 5 on page 3, op cit.

15 Petri et al 2012, op cit.

16 There is evidence that intellectual property rules inhibit innovation and economic growth – see for example, Boldrin and Levine "*The Case Against Patents*" 2012 https://research.stlouisfed.org/wp/2012/2012-035.pdf and, in specific reference to the TPPA, the former CEO of Research in Motion, Jim Balsillie http://www.huffingtonpost.ca/2015/11/11/bad-move-for-canada-tpp-s-rules-on-intellectual-property-pulled-into-spotlight_n_8538692.html

17 Bertram and Terry, op cit

dumping) and sanitary and phytosanitary measures (food safety and environmental measures).[18] There were no disputes against Japan. None of the US disputes have directly involved New Zealand and it is difficult to understand how removal of undefined NTBs could create $1.7 billion per year[19] for New Zealand exporters, almost as large as exports of meat products to the TPPA countries.

The authors of the modelling study acknowledge the uncertainties in even identifying NTBs, let alone quantifying the barrier or assessing how a trade agreement such as the TPPA might affect them.[20] The authors note that no attempt has been made to distinguish between measures that are essential for protection of health and safety and those that are maintained for protectionist purposes.[21] This conflates Non-Tariff Measures, which include legitimate domestic regulation, with Non-Tariff Barriers that are a restriction on trade and investment. The methodology then reduces the amount of regulation to the average for the region as a whole.[22]

This approach implies that societies maintaining higher levels of protection for social, environmental and health reasons, and a more developed system of business regulation, will generate benefits by removing their regulations.[23] This may be a view held by some neoliberal economists but it is not the view of many other economists, and not supported by evidence.

As a sign of the extreme range in potential estimates, the government decided to halve the estimated benefits from reductions in NTBs on goods trade without any explanation other than conceding there are limitations on the available data and modelling of NTBs.[24] Surprisingly, the estimate of gains from NTBs on services trade was not reduced. Even after the government's halving of the benefits from reduction of NTBs for goods trade, NTBs still account for 63% of the projected benefits from the TPPA.[25]

---

18 Emilija Miteva Kacarski, "*The Non-Tariff Barriers in the Developed Countries"* Faculty of Economics, University "Goce Delchev" Shtip, Republic of Macedonia, 2014 http://www.bzujournal.org/The-Non-tariff-Barriers-in-the-Developed-Countries.pdf

19 In 2007 real terms, equivalent to over $2 billion in current terms.

20 Strutt et al, para 3 and footnote 6 on page 3. One of the main sources cited in the modelling, Marco Fugazza and Jean-Christophe Maur, "*Non-Tariff Barriers in Computable General Equilibrium Modelling"* UNCTAD 2009 warns: "Our current ignorance of the true costs of NTBs is also what prevents their more rational use by policymakers."

21 Strutt et al, Appendix 5, Page xvi

22 Strutt et all, Appendix 5, page xvii

23 Perhaps surprisingly, according to the World Bank database that categorises regulations as trade restrictive, New Zealand has the second highest level of trade restrictiveness in manufacturing of any of the 12 TPP countries and the fourth highest in agriculture.

24 MFAT "Economic Modelling..." Page 2, op cit.

25 MFAT "Economic Modelling..." Page 2, op cit.

(iv) Projections for economic gains in modelling analyses

The authors of the modelling analysis commissioned by MFAT provided cautionary warnings about the assumptions behind their analysis of NTBs[26], echoed in much of the economic literature. However, these are not included in statements from the government about the benefits from the TPPA or in media reporting where a figure of $2.7 billion in benefits is used with apparent certainty. These benefits are speculative and contested, and there can be little confidence in calculations of their magnitude.

In summary, there is likely to be tangible benefit to exporters from tariff reductions, but this is likely to be considerably less than the value claimed, perhaps totalling $130 million per annum after phasing in by 2030, amounting to 0.05% of current GDP. There is inadequate evidence to support other trade benefits that make up the estimate of $2.7 billion.

The government has not provided information on the likely costs of the TPPA, other than the loss of tariff revenue ($20 million per annum) and additional costs related to an increase in the copyright term (estimated at an average cost of $55 million per annum[27]), and additional costs for PHARMAC of $2 million per annum and a one-off cost of $4.5 million.[28] Other potential costs include higher administrative, legal and compliance costs for central and local government; the costs to consumers of internet restrictions and Technological Protection Measures; the adverse impact on innovation of stronger patent protection and longer copyright terms[29]; the costs of inadequate regulation; and the costs of defending cases brought by multinationals against the government under the Investor State Dispute Settlement mechanism, and payment of any settlements or awards of compensation.

There have been two other notable modelling papers released after the completion of TPPA negotiations, with very different results. The World Bank recently released a modelling analysis which predicts a growth in GDP of around 1.1% across the twelve TPPA nations and 2-3% for New Zealand by 2030.[30] The modelling suggests that gains from TPP are likely to be slow to materialise

26 Strutt et al, page 3: "No single NTB database or set of estimates of these barriers has garnered widespread support and use within the trade community. Indeed, much of the current effort in modelling goods NTBs and services barriers is focused on improving the underlying data... we recommend that results from these [estimates] be viewed with appropriate caution. "

27 Treasury estimates obtained under OIA note that the costs from the extension of copyright may be considerably higher, a point echoed by InternetNZ in pointing out that the costs do not include allowance for the increased costs and difficulties for users in re-using copyright works http://www.nzherald.co.nz/politics/news/article.cfm?c_id=280&objectid=11572838

28 MFAT TPP Estimated benefits and areas of cost http://www.tpp.mfat.govt.nz/#benefits

29 A leaked 2010 paper from New Zealand to the TPPA negotiations warned that there is a tendency towards "overprotection" of Intellectual Property, detracting from innovation rather than promoting it, especially in sectors of rapid technological development http://www.citizen.org/documents/NZleakedIPpaper-1.pdf

30 Csilla Lakatos, Maryla Maliszewska, Franziska Ohnsorge, Peter Petri, and Michael Plummer "*Potential Macroeconomic Implications of the Trans-Pacific Partnership*" World Bank Global Economic Prospects January 2016, Page 226. http://www.worldbank.org/content/dam/Worldbank/GEP/GEP2016a/Global-Economic-Prospects-January-2016-Implications-Trans-Pacific-Partnership-Agreement.pdf.
The New Zealand GDP increase was projected to be 2.2% by 2025 in the 2012 modelling (Petri, Plummer and Zhai op cit).

and that “despite overall long term gains, member countries could experience sizeable adjustment costs in the short run.”

As with the MFAT analysis, most of the gains are projected to result from reductions in unspecified NTBs and only 15% of the gains are from tariff reductions. The report notes the high degree of uncertainty, not only in the quantification of the gains but whether restrictions on Non Tariff Measures (NTMs) will generate economic gains: “assessing NTMs and their impact is particularly fraught with uncertainty since data on the *existence of restrictive NTMs are highly uneven”*[31] (italics in original). This casts considerable doubt on the direction of economic impact, let alone the quantification as the main source of economic gains from the TPPA.

The second modelling analysis[32] uses a different modelling approach and reaches a different prediction of economic benefit. The UN Global Policy Model differs from the Computerised General Equilibrium model (used in the MFAT and World Bank approaches) in removing the assumptions of full employment and constant income distribution, and updating the baseline data (using post-Global Financial Crisis date from 2013, instead of data from 2007). This approach recognises that employment levels may reduce when a sector declines, rather than assuming displaced workers will immediately find another job.

The modelling shows an increase of 0.77% of GDP by 2025 for New Zealand, with an increase in exports, but a small decline in employment as a result of the TPPA and increased levels of income inequality.

(v) A balanced cost benefit analysis

The analysis in this section calls into question the government’s assertion that the TPPA will deliver net economic benefits to New Zealand. The extent of economic gains is likely to be far lower than predicted and costs far higher. A full cost-benefit analysis of the TPPA should be undertaken for an agreement of this scale and importance, but the National Interest Analysis that will be prepared for Parliament by MFAT is likely to fall well short on comprehensiveness and independence.[33]

The outcome of an analysis of quantifiable economic costs and benefits should be available so that decision-makers and the public can balance those against the impacts of the TPPA that are unable to be quantified but are no less important (such as lock in of trade distortions and restrictions on the right of government to regulate in the public interest).

31 Lakatos et al, World Bank op cit, Page 223.

32 Jerome Capaldo and Alex Izurieta with Jomo Kwame Sundaram “*Trading Down: Unemployment, Inequality and Other Risks from the Trans-Pacific Partnership Agreement”* Tufts University, January 2016 http://www.ase.tufts.edu/gdae/Pubs/wp/16-01Capaldo-IzurietaTPP.pdf

33 Jane Kelsey, ‘*The TPPA: Treaty Making, Parliamentary Democracy, Regulatory Sovereignty, and the Rule of Law*’, Expert Paper #1, December 2015, pp.8-10

Agriculture and Trade Rules

The prospect of additional income for the agricultural sector has repeatedly been cited as the main reason for New Zealand to negotiate the TPPA. However, during the negotiations it became evident that promise of a 'gold standard' agreement with removal of all tariffs and quotas was not possible. Agricultural gains from tariff reductions will be limited, and the benefits of tariff reductions shared with others in the supply chain (as noted in the previous section). As shown in the modelling, the tangible benefits from the TPPA are likely to consist of reductions in tariffs benefitting some exporters, primarily in the agricultural sector:

- *Dairy tariff savings* of $102 million after full implementation (30 years after the TPPA comes into force[34]) on exports of $4.6 billion to TPPA countries[35] (2.2% of export value). Significant tariffs and quotas will remain on New Zealand's dairy exports to Japan, the US, Canada and Mexico.
- *Meat sector tariff savings of $72 million per annum after full implementation on current exports of $2.3 billion to TPPA countries*[36] (3.1% of export value), mainly resulting from elimination of tariffs on beef exports, apart from Japan where tariffs reduce from 38.5% to 9% over 16 years.
- *Other agriculture, horticulture, wine and seafood tariff reductions* of $66 million per annum after full implementation on current exports of $4.8 billion to TPPA countries (1.4% of export value).

There are broader issues in the agricultural sector that are affected by the outcome of TPPA negotiations. This section analyses the extent of the TPPA's reductions in tariffs and quotas, particularly focusing on the dairy sector, the implications of the TPPA for value adding strategies and the relationships between the TPPA and WTO agricultural negotiations, focusing on the removal of trade distorting subsidies.

(i) TPPA Outcomes

Although the TPPA is often termed a regional trade agreement, access for agricultural products between the US and Japan was negotiated initially on the basis of a bilateral agreement. As a result, the TPPA allowed better access for US exporters to the Japanese market than for exporters of dairy products from other countries, including New Zealand. Japan committed to eliminate tariffs on whey and certain types of cheeses, which are key exports for the US industry, but only agreed to limited TPPA-wide tariff-rate quotas (TRQs) on skim milk powder and butter, which are major export interests for New Zealand.

Japan agreed to establish two limited TPPA-wide TRQs on butter and skim milk powder, each of which would effectively start at 3,188 tonnes and grow to 3,719 tonnes after five years.[37] To

34 The earliest that the TPPA could come into force is 2017, so full implementation will be 2047 at the earliest.

35 MFAT Fact sheet on dairy http://www.tpp.mfat.govt.nz/assets/docs/TPP_factsheet_Goods-Market-Access.pdf

36 MFAT Fact sheet on dairy, op cit.

37 USDA "*TPP Benefits to US Agriculture*", 20 October 2015 http://www.fas.usda.gov/sites/default/files/2015-10/tpp_details_dairy_10-20-15.pdf

contextualise the volume, the Chairman of Dairy NZ John Luxton characterised Japan's offer as representing the output of three large New Zealand dairy farms.[38]

Those imports are subject to ongoing tariffs of 25% or 35% for skim milk powder and 35% for butter, plus a 'mark-up' of 130 yen per kilogramme for skim milk powder and 290 yen per kilogram for butter, to be phased out over 11 years.[39]

Canada's protected dairy sector remains mostly intact under the TPPA. Only an additional 3.25% share of imports will be allowed over five years, displacing about 250 million litres of Canadian milk. Canada agreed to create new TRQs for combined exports of butter and skim milk powder from all TPPA countries that will grow to 5,121 and 8,536 tonnes, respectively, after 19 years.[40]

The US market for dairy products also remains heavily protected. For example, the US tariff on whole milk powder will be phased out over 30 years, with a 35 year quantity safeguard (allowing restrictions on imports if New Zealand volumes grow too rapidly). An initial TRQ for 1000 tonnes is established for evaporated milk and 4000 tonnes for butter, with growth of 3% allowed per annum.[41]

(ii) Implications for New Zealand agriculture

There are three major implications that arise from this analysis:

i. The gains for dairy producers (and other agricultural sectors) are relatively modest – a 2.2% tariff reduction achieved over a 22-year period is unlikely to have an impact on production decisions. It is dwarfed by exchange rate changes and commodity price movements - the Global Dairy Trade price declined by 70% from 16 April 2013 to 14 August 2015.

ii. In terms of competitive dynamics across the TPPA countries, it is likely that the US dairy industry will emerge as a significant threat to New Zealand's current low cost position. The US industry's large scale approach to agriculture provides a potential cost advantage in the production of undifferentiated commodities. In addition, the US's food system is largely one of production prioritised over quality, with the use of hormones and antibiotics permitted as a means to boost production of meat and milk.

    There is growing consumer resistance to low cost dairy and meat products with low animal welfare, genetically modified feed and hormone additives[42], and under the TPPA it will be

38 John Luxton, "*Major TPP Players holding their dairy consumers to ransom*" NZ Herald, 20 August 2014 http://www.nzherald.co.nz/rural-business-agriculture-farming/news/article.cfm?c_id=16&objectid=11499924&ref=rss.
In the raw milk equivalent terms expressed in the TPPA, the butter TRQ will start at 39,341 tonnes and increase to 45,898 tonnes after five years, while the skim milk powder TRQ will start at 20,659 tonnes and increase to 24,102 tonnes over the same period. These apply across all 11 TPPA countries.

39 USDA op cit.

40 USDA op cit.

41 USDA op cit.

42 Food safety concerns have increased by 50% over the past five years, according to a survey by Daymon Worldwide http://www.reuters.com/article/ct-daymon-worldwide-idUSnBw095217a+100+BSW20150709

increasingly difficult for the New Zealand dairy and meat sectors to use labelling to differentiate its higher standards of animal welfare, consumer health and food safety. The TPPA's chapter on Sanitary and Phytosanitary Measures includes an article on Equivalence (Art. 7.8) that will provide a powerful instrument to align New Zealand's standards to those of the US[43], and the TPPA's chapter on Technical Barriers to Trade extends beyond the WTO rules that have recently been invoked to overturn US food labelling standards, including Country of Origin labelling for meat products[44].

As is pointed out in the following section on value chains, the focus on access for commodity exports in the TPPA misses the main challenge for dairy and other agricultural sectors. As has repeatedly been pointed out, New Zealand's future prosperity depends on moving up the value chain through seeking differentiated products and higher value markets, processing our commodities, and developing strong brands, so as to overcome our vulnerability to volatile commodity prices, small scale and distance from our major markets. Keith Woodford, Honorary Professor of Agri-Food Systems at Lincoln University observed:

> The key problem with the TPP negotiations for New Zealand is the fundamental power imbalance between ourselves and the USA. And the dispute mechanisms within the TPP will reinforce that imbalance. Our business leaders will say that we cannot afford to be left out in the cold, but I would prefer a much more measured approach based on bilateral negotiations. Big is not always beautiful, especially when you are small.[45]

iii. The dairy markets for the largest TPPA countries remain heavily protected by tariffs and quotas. Only a small proportion of the markets have been opened up to New Zealand exports. The inability to remove tariffs and quotas in TPPA negotiations may serve to lock in these barriers so they become the new normal during an era when tariffs and quotas have been eliminated for all but a very few products, especially amongst the developed countries.

(iii) Trade distortions in agriculture

The lock-in of tariff and quotas in dairy under the TPPA is not the only problem that the Agreement creates. The most serious distortions in dairy trade (and agricultural trade more generally) do not result from tariffs. Rather they result from large subsidies paid to farmers in the US, Japan and other countries.

These subsidies allow their farmers to sell products at prices below their true costs of production. While New Zealand farmers are vulnerable to price fluctuations, subsidies provide protection for dairy farmers in countries like the US to maintain and even increase their production when prices

---

43 Simon Terry "*TPPA and the Environment*" December 2015
https://tpplegal.files.wordpress.com/2015/12/ep4-environment.pdf

44 WTO Dispute Settlement - US Certain Country of Origin Labelling requirements
https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds384_e.htm

45 Keith Woodford, 'TPP – It's time for a breather' August 2015
https://keithwoodford.wordpress.com/2015/08/16/tpp-its-time-for-a-breather/

are low. The vast bulk of these subsidies are not targeted towards public aims like sustainable agriculture or to support small farmers – analysis shows that most of the money goes to agribusiness corporations.[46]

The 2014 US Farm Bill will cost around US$1 trillion over the next decade according to the US Congressional Budget Office, and will cover up to 40% of dairy production costs. The new legislation not only expands subsidies paid to US farmers but also ties those subsidies more directly to recent and current production and market conditions, and therefore makes them more production- and trade-distorting.[47]

Dairy subsidies received a potentially substantial boost in the 2014 Farm Bill. Dairy farmers can participate in either the new Margin Protection Program (MPP) or use Livestock Gross Margin Insurance for dairy. MPP creates a new margin insurance scheme that offers generous insurance payouts if there is a decline in average dairy income-over-feed-cost margins. Any dairy in the United States now has access to government-subsidized margin protection on up to 90% of their recent historical production. When dairy margins drop, government payments will be significantly larger than under the previous legislation.[48]

The TPPA will not substantially affect payments to US dairy farmers under the Farm Bill. While the text says 'No Party may adopt or maintain any export subsidy on any agricultural good destined for the territory of another Party',[49] most dairy subsidies are not directly export related and will therefore remain untouched.

Further, the TPPA does not include any concrete disciplines on export credits, export credit guarantees and insurance programmes. The New Zealand government has been at the forefront of attempts in the WTO to introduce restrictions on the use of export credit programmes and emergency food aid.[50]

The best chance of reducing trade distorting subsidies is through negotiations at the WTO. The mandate of the Doha Round has included deep reductions in all trade distorting agricultural subsidies, a key priority of New Zealand and agriculture exporting countries. The potential for the WTO to tackle trade distortions was shown in the agreement in Nairobi in December 2015 to eliminate export subsidies and introduce disciplines on the use of export credit programmes and food aid.[51]

---

46 David Dayen, New Republic 5 February 2014 https://newrepublic.com/article/116470/farm-bill-2014-its-even-worse-old-farm-bill

47 Colin Carter "Some Trade Implications of the 2014 Agricultural Act". Choices Q3 2014 http://choicesmagazine.org/choices-magazine/theme-articles/3rd-quarter-2014/some-trade-implications-of-the-2014-agricultural-act

48 Colin Carter op cit.

49 TPPA National Treatment and Market Access for Goods (para 2.23.2)

50 Bridges vol 19, #39, November 2015 http://www.ictsd.org/bridges-news/bridges/news/brazil-eu-propose-tighter-wto-rules-on-agricultural-export-competition

51 "*WTO members secure 'historic' Nairobi package for Africa and the world*", WTO News, 19 December 2015 https://www.wto.org/english/news_e/news15_e/mc10_19dec15_e.htm

However, WTO deals require carefully calibrated trade-offs and a WTO deal to reduce agricultural subsidies is only possible if the US gains trade access in other sectors. If the US achieves its trade aims, such as stronger patent protection, through the TPPA, there will be little incentive for them to continue WTO negotiations and risk being required to dismantle their agricultural subsidies.

It has been unsurprising that the US Trade Representative Michael Froman has proposed to end the current WTO negotiations under the Doha Round.[52] In response, India and Brazil have insisted that the ongoing Doha Round negotiations must be concluded to remove the disparity in agricultural trade rules tilted in favour of some developed countries. They note that countries such as the US and EU spend billions of dollars annually on farm subsidies. Farmers from poorer countries say they cannot compete, given these levels of government support for their rivals.[53]

As New Zealand business journalist Bernard Hickey has observed:

> The first thing to know about America and free trade is that American politicians and officials are hypocrites and corrupt liars when it comes to free trade. They preach free trade and yet regularly oppose proper free trade deals like those proposed by the World Trade Organisation (WTO) that would actually reduce trade barriers, remove subsidies and make it easier to trade with America.[54]

The strong push for bilateral/plurilateral deals over the past 10-15 years by the US, New Zealand and other developed economies has contributed greatly to the breakdown of the WTO process, and potentially to the effective end of the Doha round. If TPPA and TTIP are ratified, it seems unlikely that there will be any further global negotiations under the WTO process, and quite possible that the WTO will cease to play an important role in the global trade system. This danger of the WTO being sidelined was highlighted by former NZ Trade Minister Tim Groser when he was running for the post of WTO Director-General.[55] He warned of the danger of smaller economies suffering from trade diversion and trade deflection as a result of TPPA and similar agreements.

In the past, New Zealand has joined developing countries in calling for an end to trade-distorting and poverty-inducing subsidies, a position that has now been undermined by its participation in the TPPA. The strategic problem for New Zealand is that signing the TPPA will undermine the only currently viable opportunity to restrict major trade distortions resulting from agricultural subsidies.[56] New Zealand farmers may receive a small gain in terms of tariff reductions, but these are likely to be far outweighed in the future by a lock-in of tariffs, quotas and trade-distorting agricultural subsidies.

---

52 Michael Froman "*We are at the end of the line on Doha Round of trade talks*" Financial Times, 13 December 2015 http://www.ft.com/intl/cms/s/0/4ccf5356-9eaa-11e5-8ce1-f6219b685d74.html#axzz3ucqz4inU

53 The BRICS Post "*India and Brazil to raise the issue of rich world farm subsidies at WTO meeting*" 15 December 2015 http://thebricspost.com/india-brazil-to-raise-issue-of-rich-world-farm-subsidies-at-wto-meet/#.VnNPeI9OJuk

54 Bernard Hickey "*Why an American free trade deal is a ludicrous and dangerous idea*" 2008 http://www.interest.co.nz/news/46687/why-american-free-trade-deal-ludicrous-and-dangerous-idea

55 Tim Groser http://www.todayszaman.com/interviews_new-zealands-tim-groser-says-wto-may-risk-becoming-irrelevant_311681.html

56 Barry Coates "*TPPA fails to tackle subsidies*" Farmers Weekly, 31 August 2015, www.agriHQ.co.nz

Implications of TPPA for New Zealand's value chains

Can the Trans-Pacific Partnership Agreement help New Zealand solve its gravest economic weakness?

The problem is we are largely exporters of raw and lightly processed commodities from which we capture only modest value. The bigger winners are our customers overseas. They use New Zealand goods to create and capture far greater value downstream, often by dealing directly with consumers.

(i) New Zealand's participation in value chains

The OECD has calculated our shortfall on wealth in a report commissioned by the New Zealand Productivity Commission.[57] Theoretically the openness of our economy and the quality of our institutions should generate GDP per capita of $43,518, 17% above the OECD average of $37,181. But our actual performance was $30,179, 19% below the average.

The OECD offered three broad remedies. Improving the skills of workers would close 5% of the substantial gap, while making companies innovative, adaptable and better run would contribute 40%. But the biggest gain, accounting for 55% of the improvement, would come from greater participation in global value chains.

The TPPA's promoters say the agreement covers a wider range of measures that will make it easier for New Zealand companies to export and to invest overseas. For example, the New Zealand Institute of Economic Research states:

> Improvements in areas such as customs, non-tariff barriers and food safety processes will reduce the cost of doing business and encourage greater participation in regional production networks. There is also an untested but potentially path-breaking new chapter on 'Regulatory Coherence' covering the role of Regulatory Impact Analysis, which can be important in minimising nontariff barriers over time.
>
> So TPP will remove some of the grit in the wheels of Asia-Pacific supply chains. This will lower transaction costs for Kiwi firms, again boosting competitiveness and opening new avenues. [58]

But such analysis focuses superficially on the ease-of-doing business rather than on far more complicated issues such as how companies develop specialised roles and relationships in value chains.

New Zealand companies have a lot to learn, judging by our low ranking in global value chains as measured by the World Economic Forum. Its Global Competiveness Report evaluates the nature

57 *An International Perspective on the New Zealand Productivity Paradox,* New Zealand Productivity Commission, 2014, http://www.productivity.govt.nz/sites/default/files/international-perspective-working-paper.pdf

58 *TPP an Impressive Achievement,* NZIER Insight 54-2015, page 2, New Zealand Institute of Economic Research, http://nzier.org.nz/publication/tpp-an-impressive-achivement-insight-54

of a country's advantage on a scale of 1 (low cost labour or natural resources) to 7 (unique products and services). In its 2014-15 report, we scored 4.1, ranking us 36th in the world.[59]

Our bigger weakness, though, is our limited role in value chains. The WEF measures this on a scale of 1 (narrow, primarily involved in individual steps such as resource extraction) to 7 (broad, present across the entire value chain including design, production, marketing and distribution). We scored 3.9, ranking us 57th in the world.

Moreover, the WEF ranked NZ 45th in terms of control of its international distribution, and 53rd on cluster development. In other words, we're poor at creating value and worse at capturing it.

(ii) The Example of Infant Formula

Useful insight into this challenge is offered by an analysis of the infant formula value chain running from New Zealand farmers to Chinese consumers. The New Zealand Committee of the Pacific Economic Co-operation Council commissioned the report from Coriolis Research.

New Zealand farmers and processors contributed 38% of the value of assets involved in the value chain, while overseas infant formula manufacturers contributed 49% and retailers 12%. But New Zealand farmers and dairy processors captured only 12% of the profits generated across the value chain, while offshore manufacturers captured 62% and retailers 25%.[60]

This imbalance between extensive assets and meagre profits reflects our dairy sector's role as largely a supplier of milk powder to infant formula manufacturers overseas, or as a toll manufacturer for them here. In the latter case, the New Zealand processors earn only a modest mark up on their manufacturing costs.

Over the past few years, various New Zealand dairy companies have been trying to move up the infant formula value chain. For example:

- A raft of small New Zealand marketing companies has attempted to build brands and distribution in China. But they have been largely thwarted by the Chinese government's strategic push to consolidate the country's dairy sector into much bigger, more capable companies.
- Synlait Milk, the South Island dairy processor, has developed close commercial relations with Bright Dairy, a major Chinese company that owns 39% of its equity.
- Fonterra has begun building up distribution in China of its own brands of formula and it has invested $750 million in an 18.8% stake in Beingmate, a major Chinese formula company.

Meanwhile, Chinese companies are stepping up their investment in New Zealand. For example, Yashili and Mengniu, two of the largest Chinese diary companies, have jointly invested $220 million in a plant at Pokeno, south of Auckland. New Zealand processors will supply milk powders it will turn into infant formula.

---

59 *The Global Competitiveness Report 2014-2015*, World Economic Forum, p291 http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf.

60 *Infant Formula Value Chain*, Coriolis Research, 2014, p35 http://nzpecc.org.nz/media/f3c9cc3577fc96acffff80caffffd502.pdf

(iii) Asymmetrical value chains

Determining how much value such initiatives will create for the New Zealand economy will be a complicated exercise. For example, the reported value of the exports tells us only the simplest part of the story. It is far harder to determine how much value is retained here, or captured offshore then returned to New Zealand by a local or foreign company. Only rigorous academic and government research will give us an answer.

So far, only a handful of New Zealand companies have developed strategies and commercial relationships that begin to move them significantly deeper into value chains.

Comvita, the health products company, is arguably one of the most advanced in terms of the value it is creating and capturing with its products, as its May 2015 presentation to investors describes.[61] For example, the retail selling price of 250 gm of generic honey is $5, while the same amount of manuka honey is worth in $330 in an antibacterial wound gel and $500 in a skincare moisturiser.

A 10-year journey to date, the strategy has multiple benefits. The company doubled its sales in New Zealand in the second half of its 2015 financial year. Most of the growth was driven by purchases here by Chinese tourists who were well aware of the company's brand from its strong profile in China.

The TPPA has an extensive section on the small and medium enterprises, which are New Zealand's dominant type of company. This specifically says signatory countries will 'facilitate the development of programmes to assist SMEs to participate and integrate effectively into the global supply chain'.

To that end each country must establish within one year of the TPPA coming into effect a special committee tasked with promoting opportunities to SMEs. Recommended initiatives include seminars, workshops, websites, identifying commercial partners in other TPP countries and helping small businesses establish their credentials.

However, only three of our top five export markets are covered by the TPPA – Australia, the US and Japan, which together account for 25% of our total exports. The two markets missing are China and the EU, which together account for 30% of our exports.

In due course, other trade negotiations might directly or indirectly deliver more help to New Zealand companies on developing their roles in value chains. These include the Regional Comprehensive Economic Partnership led by China, the Transatlantic Trade and Investment Partnership being negotiated by the US and EU, the prospective NZ-EU free trade talks, or the potential for China to join the TPPA. These negotiations, along with the TPPA, are helping to drive further development of global supply chains, Standard Chartered Bank concluded in an extensive report in May 2015.[62] Its data showed how disadvantaged New Zealand is in those chains by being a small and distant contributor to them. The report stopped short of forecasting the impact of those trends on New Zealand.

---

61 *Investor Presentation May 2015*, Comvita, http://s3.documentcloud.org/documents/2085558/investor-presentation-may-2015.pdf

62 *Global supply chains: new directions*, Standard Chartered Bank https://www.sc.com/en/resources/global-en/pdf/Research/2015/Global%20supply%20chains%20-%20New%20directions.pdf

Yet, while the TPPA and other trade agreements will facilitate two-way trade and investment, the benefits might be asymmetric. Large-scale overseas companies with close connections to their consumers will likely find it easier to tap into New Zealand resources than small New Zealand companies will find it to develop relationships with overseas consumers.

Typically, large companies are strongest in their home country. For example, in China branded consumer goods companies that are locally-owned are rapidly displacing US and European companies which have invested heavily in establishing their own brands in China for the past 20 years.

But that is changing fast as Chinese companies develop global brands. The two leaders so far are Haier in domestic appliances and Lenovo in computers. US and European multinationals will face growing competition from such Chinese consumer brands in their home and major overseas markets.

These dynamics best explain why the TPPA is so favourable to the business model and practices of US multinationals. The US is indeed, as President Obama said, trying to write the rules in its favour. This is true, for example, in the inclusion of US intellectual property principles and the exclusion of any measures to reduce agricultural subsidies (as discussed in the previous section). On the latter, US grain and dairy exports benefit from significant government support mechanisms, which put a floor under prices to ensure farmers remain cash flow positive when world prices are low.

US distortions might show up in other sectors too. It might, for example, seek to limit the help governments give to grow small and medium sized enterprises. If it did, it would be hypocritical. In the US, a mosaic of federal, state and local measures very actively contribute to economic development.

While at face value some of its measures might help New Zealand companies progress in global value chains, this analysis shows there are powerful counter-arguments that TPPA will keep them at the bottom of value chains, making them and the country poorer for it.

Economic implications of restraints on government powers to regulate

'Chilling' is the inhibition or discouragement of the legitimate exercise of natural and legal rights by the threat of legal sanction, or any legal action that would cause people to hesitate to exercise a legitimate right for fear of legal repercussions. The Investor-State Dispute Settlement (ISDS) process, with its high costs and absence of appeal rights, is clearly designed to 'chill' government policies that might threaten private corporate profits, and has already had that effect with respect to New Zealand's policy on cigarette packaging as discussed below. More generally, ISDS is designed to steer or frighten governments into pre-emptive law/policy making principles, such as minimising regulation, building-in investor influence on key decisions, and commercialising public functions, all of which reduce the risk of corporate challenge by anticipating corporate objections.[63]

The essence of the chilling process is the threat, not necessarily the actuality, of repercussions. Uncertainty lies at the heart of chilling: uncertainty over how serious the threat is (in the sense that the threatening party would actually carry through its threat); uncertainty over the outcome of legal proceedings in which novel decisions may well be made by the relevant tribunals – especially when these do not have to follow precedent, lie outside the country's jurisdiction and may be following unfamiliar legal rules; uncertainty over whether the policymaker's democratic mandate might suffer at the hands of the electorate if a dispute with a foreign corporation turns ugly.

(i) Regulatory chill: Plain packaging tobacco

New Zealanders are familiar with the chilling process from several incidents in recent history. Plain packaging of tobacco is one area where fear of possible litigation has chilled regulation in this country, given the tobacco industry's behaviour in other jurisdictions. The central issue for the industry is whether plain packaging, by eliminating the company brands on cigarettes, significantly reduces their sales and profits and confiscates a valuable intellectual property right. The central issue for national governments is to protect public health by discouraging smoking. The scale of the financial compensation tobacco companies might potentially win is huge – over

63 Kyla Tienhaara, *The Expropriation of Environmental Governance – Protecting Foreign Investors at the Expense of Public Policy*, Cambridge University Press, 2009; Kyla Tienhaara, *'Regulatory Chill and the Threat of Arbitration: A View from Political Science'*, in Chester Brown and Kate Miles (ed.), *Evolution in Investment Treaty Law and Arbitration*, Cambridge University Press, 2011, pp. 606-627; Nigel Bankes, Anatole Boute, Steve Charnovitz, Shi-Ling Hsu, Sarah McCalla, Nicholas Rivers & Elizabeth Whitsitt, "*International Trade And Investment Law And Carbon Management Technologies*", 53 Natural Resources Journal 285, 2013; Julia G. Browne, "*International Investment Agreements: Regulatory Chill in the Face of Litigious Heat?*" Western Journal of Legal Studies 3(1): 1-25, 2013; Ferdi De Ville and Gabriel Siles-Brugge, *TTIP: The Truth about the Transatlantic Trade and Investment Partnership*, Polity Press, October 2015; Benjamin W. Jenkins, "*The Next Generation of Chilling Uncertainty: Indirect Expropriation Under CAFTA and its Potential Impact on Environmental Protection*", 12 Ocean and Coastal Law Journal 269 (2007); Tracey Epps & Colleen M. Flood, "*Have We Traded Away the Opportunity for Innovative Health Care Reform? The Implications of the NAFTA for Medicare*", 47 McGill Law Journal 747 (2002); Jacob Werksman, Kevin A. Baumert and Navroz K. Dubash, *Will International Investment Rules Obstruct Climate Protection Policies?* World Resources Institute Climate Notes, April 2001

a billion dollars was claimed in the Australian case,[64] while in the UK, where plain packaging was legislated in May 2015, a figure as high as £11 billion compensation has been suggested.[65]

In 1994 Canada planned a plain packaging law, and domestic legal challenges by the tobacco industry failed,[66] but then "the proposal was dropped after a threat by former US Trade Representative Carla Hills, on behalf of two large US tobacco manufacturers, that the Canadian government would be sued for hundreds of millions of dollars under NAFTA."[67] In 2012, faced with a decision by the Australian Government to require plain packaging, the tobacco industry mounted a series of legal challenges: in the Australian High Court (unsuccessfully), on constitutional grounds;[68] before a WTO tribunal where several countries – Dominican Republic, Ukraine, and Honduras – were financed and backed by the industry to challenge the Australian position; and finally under the investor-state dispute provisions of a bilateral trade treaty between Australia and Hong Kong. At all levels there was legal advice available that the companies' case was weak[69], but the WTO and ISDS cases dragged on and have cast a shadow over policies to limit smoking in New Zealand.

The New Zealand Government announced in 2012 its intention to adopt plain packaging, but acknowledged the risk of legal action.[70] Despite introducing a bill in 2013, it deferred the final passage of any legislation until the Australian ISDS and WTO cases had been heard.[71] A 2014 submission on the bill from several lawyers argued:

> We note there has been discussion about … whether implementation should be delayed until the international legal challenges to Australia's plain packaging legislation are completed. We note these challenges are proceeding extremely slowly. In our view, it is in the interests of the tobacco industry and others that wish to discourage states

64 PCA Case Procedural Order http://www.pcacases.com/web/sendAttach/1476

65 "*Tobacco companies prepare multi-billion compensation claims over UK plain packaging*", The Telegraph, 21 May 2015.

66 Alan Hutchinson and David Schneiderman, "*Smoking guns: the federal government confronts the tobacco and gun lobbies*", Constitutional Forum 7(1): 16-22, 1995

67 David Schneiderman, Kyla Tienhaara, and Gus Van Harten, "*Reply to EFILA*", 6 July 2015 https://gusvanharten.wordpress.com/2015/07/06/reply-to-efila/

68 Alex McDonald, "*The High Court and Camel: the plain packaging decision*", New Zealand Lawyer 197: 18-19, 16 November 2012.

69 Eric Crosbie, "*Don't buckle to the tobacco industry on plain packaging", Dominion Post 29 June 2015,* http://www.stuff.co.nz/business/industries/69744829/save-lives-and-dont-buckle-to-tobacco-industry-on-plain-packaging.html provides links to the industry's legal advice in the 1990s that "international treaties offered little protection". See also pages 26-27 of the Ministry of Health's official advice to the New Zealand Government on the Smoke-free Environments (Tobacco Plain Packaging) Amendment Bill which was introduced in December 2013 and had its first reading in February 2014: Ministry of Health, *Smoke-Free Environments* (*Tobacco Plain Packaging*) *Amendment Bill Departmental Report* 18 June 2014, http://www.parliament.nz/resource/en-NZ/50SCHE_ADV_00DBHOH_BILL12969_1_A399457/12299d5de76c22d415d07e8def9ac66da02fe0b5.

70 "*Plain packs come with legal costs*", Dominion Post 24 July 2012; *"Fear of legal action slows move to plain packets"* The Press 20 February 2013.

71 "*Fear of legal action slows move to plain packets"* The Press 20 February2013.

from implementing plain packaging to prolong these cases indefinitely and to continue to discourage the implementation of plain packaging until these cases are (if ever) resolved.[72]

Philip Morris Asia's ISDS case against Australia has now been rejected on procedural grounds, which leaves undecided what a procedurally robust challenge might achieve.[73] The Australian government incurred costs of $50 million in defending the case.74 The WTO case against Australia is continuing very slowly and is expected to run for years into the future.[75]

Faced with the notorious intransigence of the tobacco industry in chilling regulation, Article 29.5 of the TPPA text includes a 'carve-out' which excludes tobacco from the ISDS provisions of Chapter 9 (Investment). While this may provide political comfort to TPPA governments fearing endless costless and wasteful litigation on that particular issue, it serves also to highlight the reasons why the general chilling potential of ISDS provisions is so strong. Transnational corporations will remain able to credibly threaten costly and lengthy litigation to deter or slow down a wide array of regulatory measures that countries might legitimately wish to impose in the interests of their citizens. In effect, ISDS clauses in international treaties impose restrictions on the scope of democratic decision-making at national level.[76]

(ii) Economic costs of ISDS

The nature of those legal challenges, and the sums of money potentially at stake, are sufficient to project a very long shadow over the economic estimates of trade benefits from the TPPA. The sums claimed, and on occasion won, by corporations in international trade tribunals run into billions of dollars. At their most optimistic, the estimated trade-related benefits from the TPPA according to MFAT's very limited modelling work amount to perhaps $2.7 billion per year by 2030;[77] more realistically only a few hundred million dollars. A central issue in weighing the costs and benefits of the TPPA is therefore whether early litigation successes against New Zealand by big corporates could potentially outweigh the limited longer-run trade gains, in present-value terms.

---

72 Professors Mark Davison and Andrew Mitchell of Monash and Melbourne Universities and Mr Lieberman of the McCabe Centre for Law and Cancer, quoted in Ministry of Health, Smoke-Free Environments (Tobacco Plain Packaging) Amendment Bill Departmental Report 18 June 2014, p.27. http://www.parliament.nz/resource/en-NZ/50SCHE_ADV_00DBHOH_BILL12969_1_A399457/12299d5de76c22d415d07e8def9ac66da02fe0b5.

73 *"Australian Government wins plain packaging case against Philip Morris Asia"* Sydney Morning Herald 18 December 2015; *"Plain packaging decision 'a massive win'"*, Waikato Times, 19 December 2015.

74 *"Australia faces $50 million legal bill in cigarette plain packaging fight against Philip Morris"*, Sydney Morning Herald, 28 July 2015 http://www.smh.com.au/federal-politics/political-news/australia-faces-50m-legal-bill-in-cigarette-plain-packaging-fight-with-philip-morris-20150728-gim4x0.html

75 *"WTO panel to hear Dispute over Australia Plain Packaging Tobacco Law"*, Bridges, vol 18, no 15, 1 May 2015

76 See David Schneiderman, *Constitutionalizing Economic Globalization*, Cambridge University Press 2008.

77 See section 1 above. http://www.tpp.mfat.govt.nz/assets/docs/TPP%20-%20CGE%20Analysis%20of%20Impact%20on%20New%20Zealand,%20explanatory%20cover%20note.pdf.

Reactions by electricity industry companies to the 2013 Labour/Greens proposal to set up a "single buyer" for wholesale electricity as a means of curbing corporate profit-taking in that sector clearly signalled another area where the availability of an investor-state dispute mechanism could chill future policy initiatives along the same lines. At stake in the Power New Zealand proposal were corporate profits somewhere between $700 million[78] and $1.5 billion[79] per year. As an overseas-owned company, Contact Energy would now be able to resort to (or threaten) ISDS litigation in response to any revival of plans to regulate electricity prices.

Another example of the scale on which compensation can potentially be sought for a 'regulatory taking' is the 2006 forced breakup of Telecom via 'unbundling of the local loop', a regulatory action that reduced the market power exercised by Telecom as monopoly owner of telephone lines from exchanges to customer premises. According to the Business Roundtable, this had 'shaved $3 billion off Telecom's share price'.[80] A similar complaint arose when the Labour government in March 2008 regulated to block the purchase of Auckland International Airport by the Canadian Pension Plan Investment Board, causing the value of AIAL shares to drop by around $300 million.[81]

New Zealanders will remember the 2010 policy debate over mining-company access to Schedule 4 conservation land for the purposes of mineral prospecting. A feature of that debate was the size of the dollar numbers produced by the mining lobby: $194 billion, often rounded up to $200 billion, was allegedly the value of the minerals 'locked up' by Schedule 4 of the Crown Minerals Act. Although demonstrably wrong as a measure of actual economic value[82] the figure produced by the mining lobbyists was uncritically adopted by the New Zealand Government[83] and gives some idea of the scale at which corporate plaintiffs might pitch their claims for compensation once the TPPA procedures become available to them, in the event that they consider themselves illegitimately excluded from prospecting opportunities in New Zealand. Occidental Petroleum in a 2013 case secured $2.3 billion judgment ($1.77 billion plus interest) against Ecuador for that

78 NZ Labour Party press release 18 April 2013 "*New Zealand Power – Labour leader's remarks"*.

79 Geoff Bertram, "Asset revaluations, price gouging, and barriers to entry: the state of play in electricity sector non-regulation", 24 May 2013, http://www.geoffbertram.com/fileadmin/publications/Asset%20revaluations,%20price%20gouging,%20and%20barriers%20for%20website.pdf.

80 Roger Kerr, *Property Rights, Regulatory Takings, and Compensation*, 8 July 2011, http://nzinitiative.org.nz/shop/Library+by+type/Property+Rights+Regulatory+Takings+and+Compensation.html.

81 See *Complaint regarding the Overseas Amendment Investment Regulations 2008: Report of the Regulations Review Committee* September 2008, http://www.parliament.nz/resource/en-NZ/48DBSCH_SCR4225_1/0b2c2a95bc93dd997d5e481d5b93d919ea5fe96c.

82 Geoff Bertram, "*Mining in the New Zealand economy"*, Policy Quarterly 7(1): 13-19, February 2011, page 16 suggested that $200 million was a better estimate – about one-thousandth of the industry's claim.

83 Ministry of Economic Development, *Maximising our Mineral Potential: Stocktake of Schedule 4 of the Crown Minerals Act and Beyond*, March 2010, p.2.

country's withdrawal of oil concessions in the Amazon.[84] Lone Pine Resources is pursuing a $250 million claim against Canada under the NAFTA trade agreement over Quebec's ban on fracking.[85]

(iii) Climate change mitigation

An obvious likely area of potential trouble with dispute resolution lies in the area of climate change and renewable energy. With very large vested interests engaged in the profitable supply of fossil fuels to industry and transport, the incursion of renewable energy sources and electric vehicles presents a massive competitive challenge, and it will be extremely difficult for future policymakers pursuing emission reduction targets to escape the charge of 'tilting the playing field', whether by withdrawing existing subsidies to fossil fuel supply or by assisting the introduction of renewables. As global efforts to mitigate greenhouse-gas emissions intensify over coming decades there will be continual struggles over whether competitive neutrality is breached, or property rights expropriated, by the measures governments will have to take to achieve emission reduction targets. Equally, carbon emission trading has created valuable financial instruments; any changes to that regime that undermined their value could trigger an investment dispute.

A foretaste of those battles is to be found in several recent cases under international trade and investment law where programmes to subsidise or promote renewables have come under challenge, or where changes in existing subsidy programmes have triggered investor-state disputes. In a well-known Spanish example, the withdrawal of a subsidised feed-in tariff that had attracted international investors to commit to installing solar generation equipment attracted a flood of claims alleging loss of profits.[86] In the case of Ontario, the province's attempt to *introduce* a subsidised feed-in tariff was successfully chilled by the threat of litigation.[87] Following Germany's decision to phase out its nuclear generation plants Vattenfall, a Swedish company with two nuclear plants in Germany, demanded compensation of €3.7 billion ($4.7 billion) under the ISDS clause of a treaty on energy investments.[88]

Recent proposals for the use of targeted tariffs to protect international carbon-pricing 'club' arrangements have brought to the fore the clash between effective emissions-reducing policy and the current state of international trade law, and the possibility that unless trade law is modified

---

84 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case* No. ARB/06/11, http://www.italaw.com/sites/default/files/case-documents/italaw1094.pdf. For details see Tai-heng Cheng, "*ICSID's Largest Award in History: An Overview of Occidental Petroleum Corporation v the Republic of Ecuador*", Kluwer Arbitration Blog 19 December 2012, http://kluwerarbitrationblog.com/2012/12/19/icsids-largest-award-in-history-an-overview-of-occidental-petroleum-corporation-v-the-republic-of-ecuador/ ; and Investment Treaty News 14 January 2013 https://www.iisd.org/itn/2013/01/14/awards-and-decisions-10/.

85 Gerard Montpetit, "*The Trans-Pacific Partnership puts democracy up for sale*", Huffington Post 10 September 2015 http://www.huffingtonpost.ca/gerard-montpetit/democracy-for-sale_b_8263960.html

86 See Kyla Tienhaara, "*Does the green economy need investor-state dispute settlement?*", Investment Treaty News 26 November 2015, http://iisd.us3.list-manage.com/track/click?u=78abf941b6786fcaoed7e367d&id=63285ac013&e=07adac19a6.

87 Naomi Klein, *This Changes Everything*, Penguin 2014 p.110.

88 "*The arbitration game*", The Economist 11 October 2014.

it will operate to chill action on climate change.[89] (The issue here is whether a 'club' of nations that agrees to impose a common carbon-price floor across all their economies is legally able to impose a common external tariff against countries who apply a lower carbon price and thus create an artificial competitive advantage for their producers.)

The conclusion from this brief review of some immediate concerns over the chilling of regulation is that there is enormous uncertainty over both the scale of possible awards of compensation to which New Zealand might be exposed, which may include lost future profits and compound interest, and the size of the foregone regulatory opportunities to raise national welfare, which might well exceed the actual damages anticipated from actual and threatened disputes, because of the cumulative impact of chilling. The scale of uncertainty over possible damages is highlighted by the US Congressional Budget Office's attempt to quantify the amount of compensation that might be won under US 'takings' law,[90] in response to federal restrictions on the rate of converting wetlands to urban development. The estimates ranged from $370 million per year to $1.85 billion per year.[91]

The New Zealand government has not to date undertaken (at least, it has not published) any estimate of the costs of regulatory chilling under the TPPA. Nor has it (apparently) carried out any review of the scope and scale of investor-state disputes that may open up as a result of signing the TPPA. Some consideration of these issues would be an essential part of any thorough cost-benefit assessment of the deal.

89 William Nordhaus, "*Climate Clubs: Overcoming Free-Riding in International Climate Policy*", American Economic Review 105(4): 1339-1370, April 2015.

90 The regulatory takings doctrine in the US is similar to indirect expropriation in Article 9.7 of the TPPA.

91 *Regulatory takings and proposals for change*, December 1998, https://www.cbo.gov/publication/1132, Chapter 7.

The TPPA: A flawed model for the 21st century

The Trans-Pacific Partnership is a trade agreement for the 21^{st} century, say presidents, prime ministers and other promoters of it. They argue its rules will shape the way trade and investment are conducted by its 12 countries, which in turn will change the way the world does business. As President Barack Obama said after agreement was reached in Atlanta on October 5^{th}:

> When more than 95 per cent of our potential customers live outside our borders, we can't let countries like China write the rules of the global economy. We should write those rules, opening new markets to American products while setting high standards for protecting workers and preserving our environment.[92]

This is a very US-centric view of the world, however. China and the European Union, the two major trading blocs that aren't parties to the TPPA, are promoting different agendas.

Three possible alternatives arise: China and the EU will negotiate changes to the TPPA before they join or link with it; they will promote their own trading blocs, thereby causing tension between trading blocs; or they will accept the US's remaking of global business rules. Given what is at stake economically and geo-politically, the third option is the least likely.

Whichever way these options play out, New Zealand will have to exercise exemplary diplomatic skills to remain onside with all three of the major blocs.

TPPA's first flaw is its sub-optimal coverage. Its signatories account for 37% of world GDP and 11% of world population. But it lacks the leaders of the largest economic and population blocs in the world. The EU generates 46% of global GDP and China is promoting the rival Regional Comprehensive Economic Partnership whose 16 countries account for 49% of people and 29% of GDP.

China has many economic and strategic reasons not to acquiesce to the US. The two biggest are closely linked. First, it is determined to achieve over the next two decades the greatest economic transformation in its history. This is the leap from the second wave of industrialisation to the fourth, from heavy manufacturing to high technology.

Second, it needs its neighbours to help it achieve this unprecedented feat. The more sophisticated the Chinese economy becomes, the higher its labour and other costs. Thus China is increasingly tying its less developed, lower cost neighbours into its supply chains.

Detailed analysis of this is included in Standard Chartered Bank's recent study of the impact on global supply chains of the next wave of trade agreements, particularly TPP, RCEP and the Transatlantic Trade and Investment Partnership which the US and EU are negotiating.[93]

The study shows clearly how rapidly China is integrating its neighbours into its economy. For example, China has a high, and fast growing, rate of 'backward participation' in supply chains.

92 https://www.whitehouse.gov/the-press-office/2015/10/05/statement-president-trans-pacific-partnership

93 *Global supply chains: new directions*, Standard Chartered Bank https://www.sc.com/en/resources/global-en/pdf/Research/2015/Global%20supply%20chains%20-%20New%20directions.pdf

This means it imports materials and goods from other countries, which then add value to its own end-use exports. But it has a low, and falling, rate of 'forward participation'. This means it exports relatively little in value terms that is used by other countries in their end-use exports.

Most TPPA members are important to China as neighbours and participants in its global supply chains, notably Vietnam, Malaysia, Japan, Singapore, Australia, New Zealand and Canada. China likely wants to shape the rules of trade with them rather than accept the US version.

The TPPA's rules on intellectual property and trade in services are two further reasons why China will want to either promote RCEP in competition with TPPA or modify TPPA before joining it.

Again, the two reasons are linked for China. Its economic transformation hinges crucially on its ability to develop, commercialise and defend intellectual property. That in turn is vital to China's ambitions to develop high value services as a growth engine of the economy as manufacturing's contribution becomes relatively less prominent.

But as the TPPA stands, its rules on IP and trade in services are very US-centric. As a result, US companies will be the greatest beneficiaries, according to analysis from a number of diverse experts[94].

For example, Bill Watson, a trade policy analyst at the Cato Institute, says: [95]

> Imposing intellectual property rules through trade agreements has become a political liability that serves special interests at the expense of free trade.
>
> Unlike tariff reductions, extending intellectual property rights in foreign markets does not directly benefit foreign consumers. At the same time, there is the potential for harm to US consumers when international obligations make domestic intellectual property laws harder to reform or, in some cases, stricter than they would be otherwise. Using trade negotiations to set patent and copyright policy gives excessive power to industry without any justification.
>
> Global rules already exist that prevent piracy or severe regulatory differences. The World Trade Organization imposes minimum standards for patent copyright protection and prohibits discrimination. Intellectual property rules in the TPP, on the other hand, are about things like extending copyright terms from really long to really, really long. Getting Canada to impose a longer copyright term may benefit Disney, but that shouldn't be a goal of U.S. economic relations.

94 *This point was made in a leaked New Zealand paper submitted to the TPPA negotiations, stating that "The problems of overprotection* [*of IP*] *are particularly acute for technology importing countries"* http://www.citizen.org/documents/NZleakedIPpaper-1.pdf

95 http://www.huffingtonpost.com/bill-watson/for-free-trades-sake_b_4325963.html

US service companies are the winners under the TPPA, according to analysis by Peter Petri and colleagues at the Petersen Institute of International Economics in Washington. They forecast the US will claim US$68 billion of the US$99 billion a year increase in service exports when TPPA is fully implemented after 10 years. In contrast, US goods exporters will claim only US$58 billion of the $209 billion increase in TPPA exports.[96]

The authors give two main reasons for this. US service companies are "exceedingly efficient", highly skilled and technologically competent. This makes them much stronger than their competitors in the TPPA, and therefore best placed to capitalise on the lowering of barriers to trade in services agreed in the TPPA.

From the EU's perspective, one of the greatest disconnects between it and the TPPA is on Investor State Dispute Settlement. EU companies are active users of the varying ISDS mechanisms in many existing treaties. Of the 568 ISDS cases involving 98 countries filed up to 2013, EU companies were responsible for more than half of them, according to UN's Conference on Trade and Development.

But in recent years, the use of ISDS has become a 'very toxic issue', Cecilia Malmström, the EU's Trade Commissioner has said.[97] Problems include the lack of transparency or an appeals process, and the chilling effect ISDS can have on countries' public policy.

In its TTIP negotiations with the US, the EU has proposed that the arbitration system should become more like conventional courts, with permanent arbitrators, qualified judges and greater public access. The EU would also seek to establish an international investment court to replace bilateral schemes.[98]

If the EU succeeds in shifting the US from ISDS to an international investment court in a completed TTIP agreement, then the TPPA should be upgraded in the same way, regardless of whether the EU eventually joins it.

The TPPA falls far short in other ways of being an agreement for the 21st century. Crucially, climate change does not get a single mention in the treaty. Yet it will have profound impacts on social stability, human health, technology transformation and economic progress. Instead, environmental coverage of the TPPA extends only to important, but by comparison minor, issues such as trade in endangered species.

These environmental goals are a curious and conflicting mismatch of US agendas thanks to convoluted US domestic politics, as Simon Terry explains in his expert paper on TPPA and the environment.[99]

---

96 Peter A. Petri, Michael G. Plummer, and Fan Zhai, 2012, *The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment*, Washington: Petersen Institute for International Economics. The preceding section on economic modelling casts doubt on the scale of benefits projected to result from a reduction in non-tariff measures.

97 Cecilia Malmström in EU Parliamentary hearing https://euobserver.com/news/125797

98 http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf

99 Simon Terry "TPPA and the Environment" December 2015 https://tpplegal.files.wordpress.com/2015/12/ep4-environment.pdf

Nor does the treaty give even faint acknowledgement of radical change being wrought by the likes of the collaborative and sharing economies (exemplified by companies such as Uber and Airbnb), and social enterprises.

Likewise, as TPPA stands, it will likely limit governments' ability to innovate in policies, regulations and programmes to address deeply entrenched inequalities in health, education and income and fast-escalating problems such as environmental degradation. Moreover, the US explicitly states the TPPA is designed to exclude China, or at best to only allow China to accede to the treaty if it accepts the treaty in full and unchanged.

As a result, the TPPA reads very much like a charter for incumbent businesses, with US companies to the fore, that are attempting to hold back the tides of economic change the world needs.

The paper was coordinated by Barry Coates. The section on Modelling Economic Benefits was authored by Tim Hazledine[1] and Barry Coates; the section on Agriculture was authored by Barry Coates[2]; the sections on Value Chains and 21st Century Agreement were authored by Rod Oram[3]; and the section on the chilling effect on Regulation was authored by Geoff Bertram[4]. The paper was reviewed by Professor John Quiggin[5].

This is one of a series of research papers coordinated by Professor Jane Kelsey and Barry Coates that will be posted on www.TPPlegal.wordpress.com. The research papers have been prepared under tight time constraints and are not comprehensive. A full and independent assessment of the TPPA's likely impact on key issues, including the environment, health, social wellbeing and human rights is required. This needs to be undertaken prior to ratification of the TPPA.

Financial support for the series of research papers has been provided by the New Zealand Law Foundation. While we gratefully acknowledge their support, responsibility for the content rests with the authors. The series has been designed by Michael Kenara and Eleanor McIntyre with support from the New Zealand Public Service Association.

1 Tim Hazledine is Professor of Economics at the University of Auckland Business School.

2 Barry Coates is developing a sustainability programme at University of Auckland Business School.

3 Rod Oram is a journalist writing on corporate, economic and political issues. He is a columnist for The Sunday Star-Times, a regular broadcaster on radio and television and a frequent public speaker.

4 Geoff Bertram is Senior Associate at the Institute for Governance and Policy Studies at the Victoria University of Wellington.

5 Professor John Quiggin is an Australian Laureate Fellow in Economics at the University of Queensland.