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FX HORIZONS: The Big Good-News Story You've Heard Little About

By: Michael J. Casey – April 17, 2013

As far as business-news headlines go, "Japan, U.S. Agree on Trade-Talks Entry" could never compete for shock value with "Gold Plummets to Two-Year Low."

But make no mistake: Last week's U.S.-Japan agreement allowing Tokyo to engage in negotiations for the Trans-Pacific Partnership was a very big deal. The third-largest economy in the world has joined 10 others in talks over a trade agreement that would encompass 40% of the world economy. Most importantly, the agreement intends to go "inside the border" to force governments to drop a vast array of restrictive trade practices that until now have been outside the reach of international rules. If a pact is eventually signed, the long-term implications for global prosperity will be far bigger than anything happening in the gold market.

This is not only a good-news story, it's a timely one. Free-trade initiatives are a welcome antidote to the international tensions that are currently fueling talk of war–both of the military and currency variety.

Of course, there will be strong voices of opposition from vested industrial interests in each country. But in terms of aggregate economic outcomes, the net benefits from trade liberalization are irrefutable. The improvements seen globally in income, education and health indicators since the 1994 General Agreement on Tariffs and Trade, or GATT, are already impressive. With that in mind, finance ministers from the Group of 20 nations meeting in Washington later this week should focus more on the long-term opportunities posed by Japan's accession to the TPP talks than on the short-term challenges posed by the sliding value of the yen.

Before we get too carried away, though, some caveats. Even if the TPP negotiations come to a successful conclusion over the next year, most countries will require legislative ratification. And there the same old stumbling blocks loom. Will a U.S. Congress finally accede to demands from Australia and other signatories that it unwind farm subsidies? Will Japan expose its rice farmers to competition? Will Asian countries open up their crony-led financial sectors?

One worry is that President Barack Obama, having had virtually no trade agenda in his first term, has now bitten off more than he can chew. The U.S. President currently doesn't have "fast track" negotiating authority, which lapsed under George W. Bush in 2007. By simultaneously planning a trade deal with the European Union, Mr. Obama may be spreading his political capital too thin, says American Enterprise Institute scholar Claude Barfield.

Mr. Obama has already been heavily influenced by one of the most powerful lobbying forces in the U.S., raising questions about how cleanly this process can proceed. The deal with Japan allowed for a continuation of U.S. tariffs on foreign-made cars and trucks, which Cato Institute scholar Daniel Ikenson says “almost demonstrates that our economy is a life-support system for the auto industry.”

All cynicism aside, however, the TPP is a huge opportunity. That it is driven as much by politics as economics may, in fact, increase its chances. For Washington and Japan, the pact works as a counterpoint to China’s influence, one that is far more effective and less risky than ramping up the U.S. military presence in the region.

China has chosen not to apply for TPP membership and, instead, is pushing hard for an alternative regional proposal that excludes the U.S. There is no surprise in that. Some of the TPP’s most-promising features–rules limiting favors for state-owned enterprises, limits on capital controls–directly attack Beijing’s economic model.

But whereas critics such as Columbia University Professor Jagdish Bhagwati complain that the pact’s blatant anti-China politicizing undermines the goal of market-driven, global free trade, it is also a deft piece of realpolitik. Chinese leaders themselves know they must eventually open up their financial sector, free up capital flows, and submit their outdated government-owned firms to competition if their country is to continue developing over the long term. The TPP would simply force them to move more quickly. If China eventually feels compelled to join a giant new free-trade area from which it is initially excluded, much as it did with the World Trade Organization in 2001, vast new opportunities should open up in the world’s second-largest economy for companies from the U.S. and the other signatory nations. It is a roadmap to global growth.

To be sure, trade negotiations often don’t live up to promises, as the failed Doha round proved. But the TPP, imperfect as it is, is free trade’s best shot in years. Don’t pop the champagne yet. But do pay attention to this story.