

The Economic Impacts of EPA – GTAP Model Simulations

Dr *Kenichi Kawasaki*, Counselor of the Cabinet Secretariat, Japan, spoke at an International Affairs Forum chaired by **Tan Sri Dato' Seri Mohamed Jawhar Hassan**, Chairman and Chief Executive, ISIS Malaysia on 19 August 2013. ISIS Analyst **Zarina Zainuddin** reports.

Dr Kenichi Kawasaki in his talk discussed his study on the economic impact of the Economic Partnership Agreement (EPA), in particular the GTAP model simulation, which meant impact assessments in a quantitative rather than qualitative manner. GTAP stands for the Global Trade Analysis Project, a global network of researchers and policy makers who conduct quantitative analysis of international policy issues. It is coordinated by the Center for Global Trade Analysis in Purdue University's Department of Agricultural Economics.

Three findings were discussed. One was the potential impact of the signing of the Trans Pacific Partnership (TPP) on the Japanese economy, future areas of economic study, and finally, the impact on the Malaysian economy of moving from bilateral EPAs to multilateral EPAs.

Kawasaki said it has been the practice of the Japanese government to set up a joint study group with the country it is considering an EPA with before negotiations begin in earnest. This was the case with the Japan-Malaysia Economic Partnership Agreement (JMEPA), where a working group was first formed to discuss terms of reference for the EPA. This was followed by a joint study group which discussed in detail various topics, including liberalization, facilitation of trade in goods and services, and the impact of the EPA on economic sectors. The final report was submitted in December 2003, two years before the JMEPA was officially signed.

The Japanese government has also made it a practice to do a study on the potential impact of such an EPA on the Japanese economy in order



Kenichi Kawasaki

to inform Japanese stakeholders, the public, private enterprises, the media and academia. The most recent study, presented by Kawasaki in his capacity as Counselor of the Cabinet Secretariat was the numerical estimate of the impact of TPP on the Japanese economy using the GTAP model. Unfortunately, said Kawasaki, since Japan was unable to join TPP negotiations until very recently, it is only able to unilaterally estimate the potential impact of participating in TPP negotiations.

In assessing the economic impacts of EPAs, said Kawasaki, sustainable impact is the key phrase in terms of determining the economic benefit that a country can gain. Sustainable impact refers to impact remaining unchanged even after the EPA has been realized; hence sustainable impact translates into sustainable economic benefits.

Kawasaki said his study estimates that assuming 100 per cent tariff removals as a result of Japan's participation in TPP, real GDP would be boosted by 3.2 JPY trillion, accounting for 0.66 per cent of GDP. However, according to other studies, those macroeconomic benefits could be much larger if the impacts of Non Tariff Measures (NTMs) reductions and liberalization of services and investment are included.

Lastly, Kawasaki argues that the TPP and the Regional Comprehensive Economic Partnership (RCEP) will be complementary rather than competitive towards the larger goals of establishing the Asia Pacific region wide FTAAP or Free Trade Agreement Asia Pacific. RCEP members include ASEAN 10 plus Japan, Korea, China, India, Australia and New Zealand (original members of the East Asian Summit) and FTAAP is the free trade agreement envisioned for members of Asia Pacific Economic Cooperation (APEC) (Fig 1).

Japanese Government Growth Policy

Current Japanese Prime Minister Abe's key policy measures for economic growth have been likened to 'shooting three arrows.' The first is monetary expansion by the Bank of Japan (BOJ). The second is the fiscal stimulus package by the Ministry of Finance, including aid packages for recovery from the earthquake and third, major structure reforms including participating in EPAs. What is the difference between the three reforms? Kawasaki said monetary expansion or fiscal expansion is efficient in boosting the economy in a short-term business cycle adjustment.

However for medium-to-long term growth, the third arrow, that is structure reform, is needed and is deemed the backbone of the economic policy of the current administration. One way to ensure domestic reforms is to participate in EPA; adherence to the terms of the

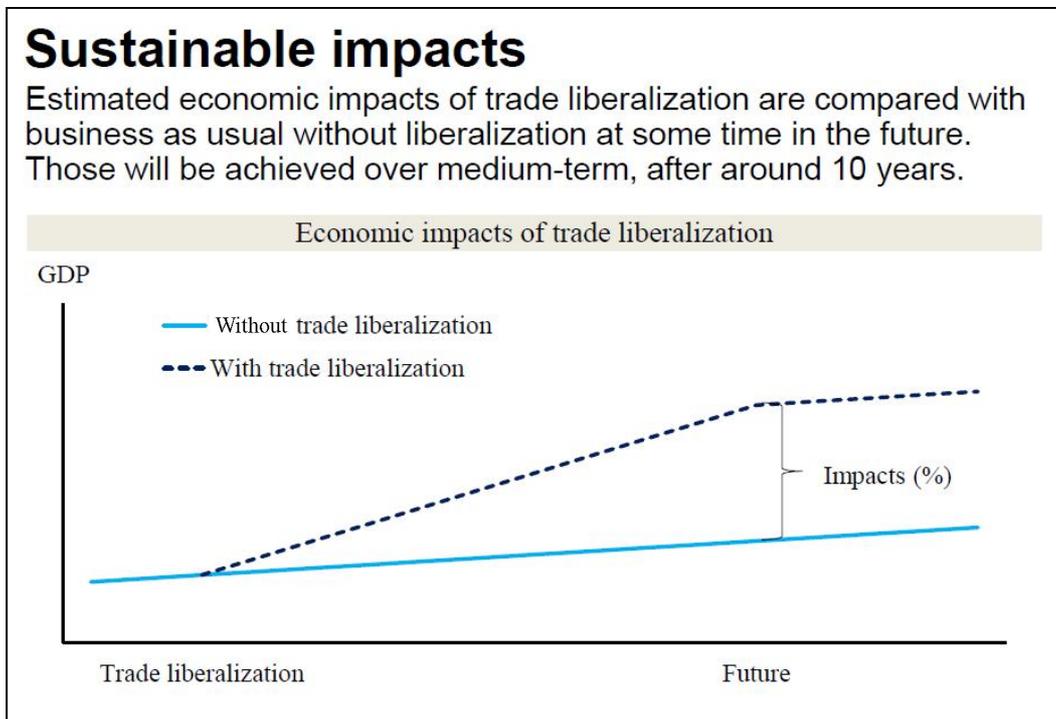


Figure 1

agreement would lead to liberalization and increased competition in economic sectors, leading to sustained macro-economic benefits.

In measuring the impact of Japan's participation in the TPP, Kawasaki assumed immediate 100 per cent tariff removals for all the participants in TPP (including Japan and Malaysia, Australia, and the US). There would be no NTM reductions or liberalization of services and investment and no additional policy measures implemented (Fig 2).

The TPP according to Kawasaki will boost the Japanese economy by 0.66 per cent. He then

However, an increase in imports contributes to a decrease in domestic production, which is why an increase in imports contributes in a negative manner to GDP growth/a country's income. So while exports and imports will be boosted, if imports reduce total GDP activity, then exports will do the reverse, i.e. increase GDP activity, and in the end the nett result will be a neutralizing by one of the other.

But the third component is quite important – if imports result in cheaper commodities from overseas which in turn will boost household real income, real consumption will be rapidly boosted. So it is real consumption,

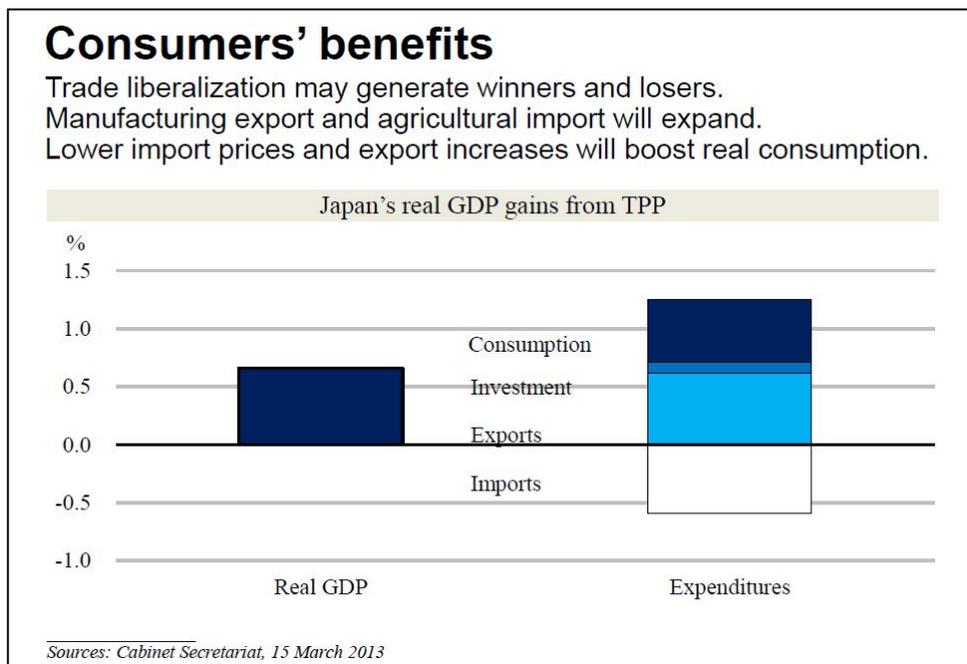


Figure 2

broke down the impact into different components: imports, exports, consumption, and investment. Clearly exports would be boosted because of the opening of trade and the absence of restrictions on products that the Japanese are competitive in. Imports would be boosted as well while restrictions and trade impediments would be dismantled.

not imports or exports that will boost the country's income. That's why, said Kawasaki, the third arrow of reform measures could be more beneficial to domestic reform measures, by switching benefits from producers to consumers. That's why macroeconomic gains can be expected.

When the previous government mooted the idea of joining the TPP, it failed to gain much support. One of the main reasons was confusion about potential gains in joining the TPP. Three different figures were released on the TPP's impact on the economy — each with a different outcome: (a) Kawasaki's, which estimates gain at the macroeconomic level; (b) negative outcome from the Ministry of Agriculture, Forest and Fishery (MAFF) which estimates negative impact on the agriculture sector and, (c) mixed outcome from the Ministry of Economics, International Trade and Industry (MEITI) on the impact on the manufacturing sector.

The Abe administration has learned from past mistakes, and now only one figure was released on the key outcome of the TPP's impact on the economy: Kawasaki's GTAP model, released in March this year, which incorporates estimates from both MAFF and MEITI — a key

achievement, according to Kawasaki. This time the response from the public was more muted.

Kawasaki continued with the second part of his talk which was on future areas of study including analysis of the impact of non-tariff measures, assessing the impact of the TPP or RCEP, and comparing his study with that of Peter A Petri of Brandeis University. The studies estimate the impact of the TPP, RCEP and the Asia Pacific Free Trade Area (APFTA) (Fig 3).

Findings

Petri's study estimated a much larger gain in the Japanese economy compared to Kawasaki's study. The reason is clear: Kawasaki studied the impact of tariff removal while Petri studied the impact of removal of NTMs on services, and investment liberalization which cover a much larger area of the EPA. According to Petri's study, a country can

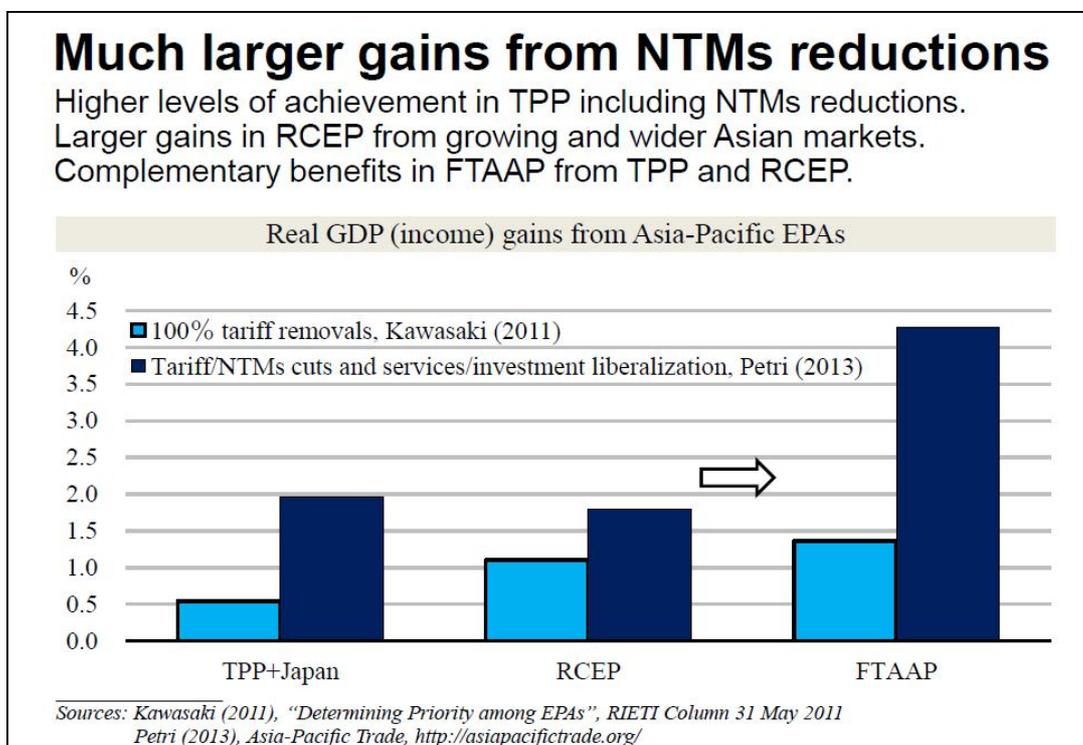


Figure 3

benefit more from NTMs, services, and investment liberalization than from focusing solely on the market access issue of tariff removal.

The second minor difference between the two studies is that the Japanese macroeconomic gain could be larger from RCEP rather than TPP, mainly due to the respective main players, RCEP's main player being China and the TPP's being the US. China has a bigger economic presence than the US for most countries in the region.

However, Petri asserted that the Japanese benefit could be greater in the case of the TPP (slightly more than RCEP) mainly because in the case of East Asia, the level of ambition and limitations in removing tariffs are lower compared to the TPP standard. It was a chief assertion in Petri's study, that in the case of the RCEP, tariffs cannot be removed 100 per cent, and judging from studies of past EPAs in the region, a 90 per cent tariff removal is a likely target.

In the case of the TPP, given the more vigorous nature of its negotiations, one can expect more tariff removal measures and this coupled with the expected liberalization of investment and services, Petri argues, would yield a bigger gain than from RCEP. Kawasaki said that ultimately where RCEP or TPP will yield the bigger gain will very much depend on the final outcome in the terms of the negotiations (Fig 4).

Finally, the most important common finding made by both Kawasaki and Petri was that the impact from APFTA would be much larger than from either TPP or RCEP. This is the reason why Kawasaki wants TPP and RCEP to be treated as complementary rather than competitive processes. The total impact from APFTA in terms of microeconomic gains could be larger than from TPP or RCEP. Hence APFTA should be the endgame while RCEP and TPP would be steps forward towards achieving the endgame.

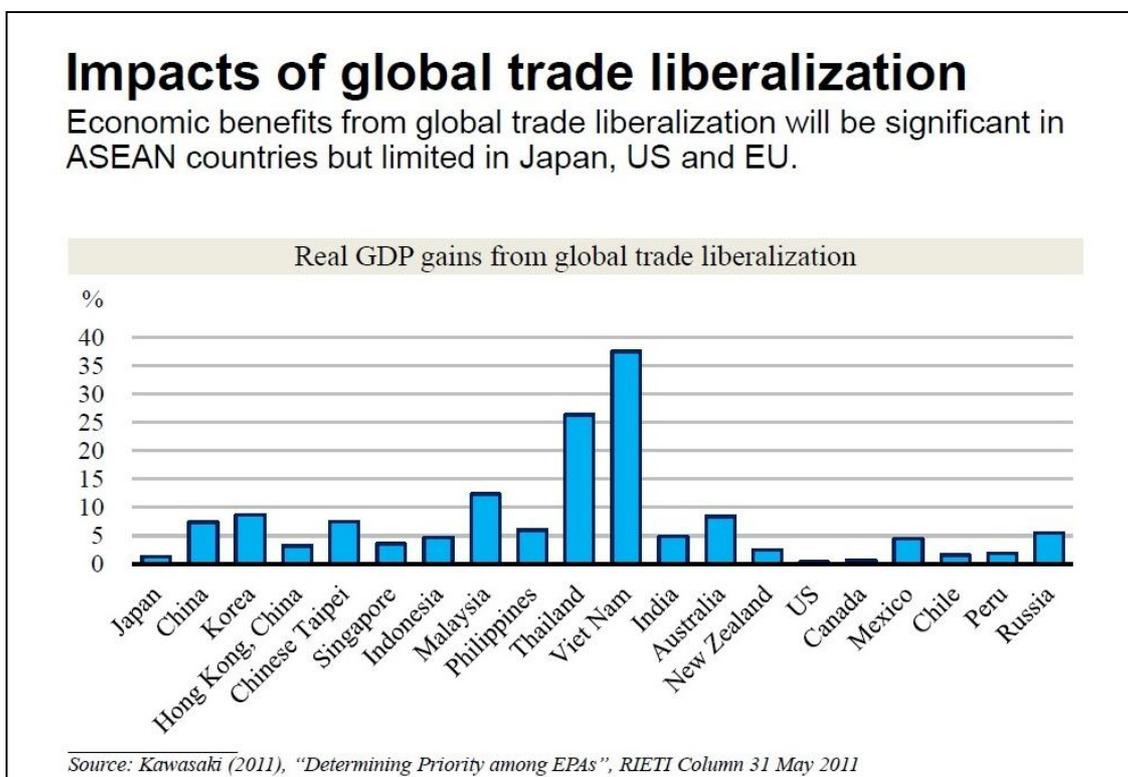


Figure 4

The Case of Malaysia

Kawasaki estimates that Malaysia's gain from participation in the TPP would be a rise in real GDP of 4.6 per cent; the corresponding macro-economic gains would be 8.3 per cent from RCEP and 9.4 per cent from APFTA. As in the case of Japan, Malaysia's gain would be larger in RCEP than TPP. Likewise, Petri's study finds Malaysia's gain from TPP participation to be a 5.6 per cent hike in income, greater than the 3.3 per cent gain from RCEP. Like Kawasaki, Petri's estimate of Malaysia's participation in APFTA yields the biggest gain at 8.9 per cent.

Lastly, Kawasaki shares his findings on which bilateral EPAs would give the largest impact

in terms of income gains in Malaysia's economy. He indicates that bilateral EPA with China would give the largest gain followed by EPA with the EU, Japan, the US, Korea and India (Fig 5). The corresponding figures for Japan also ranks China at the top, followed by the US, Thailand, EU, and Australia. Malaysia ranked at the eighth spot (Fig 6). If one takes into consideration the built-in assumptions in Kawasaki's and other such studies, such insightful findings could be useful for policy study or trade negotiators to decide on which bilateral EPA should be prioritized, given resource constraints and human capacity. It could also put in perspective which TPP and RCEP should be pursued and how, while keeping in sight the endgame (in this case APFTA).

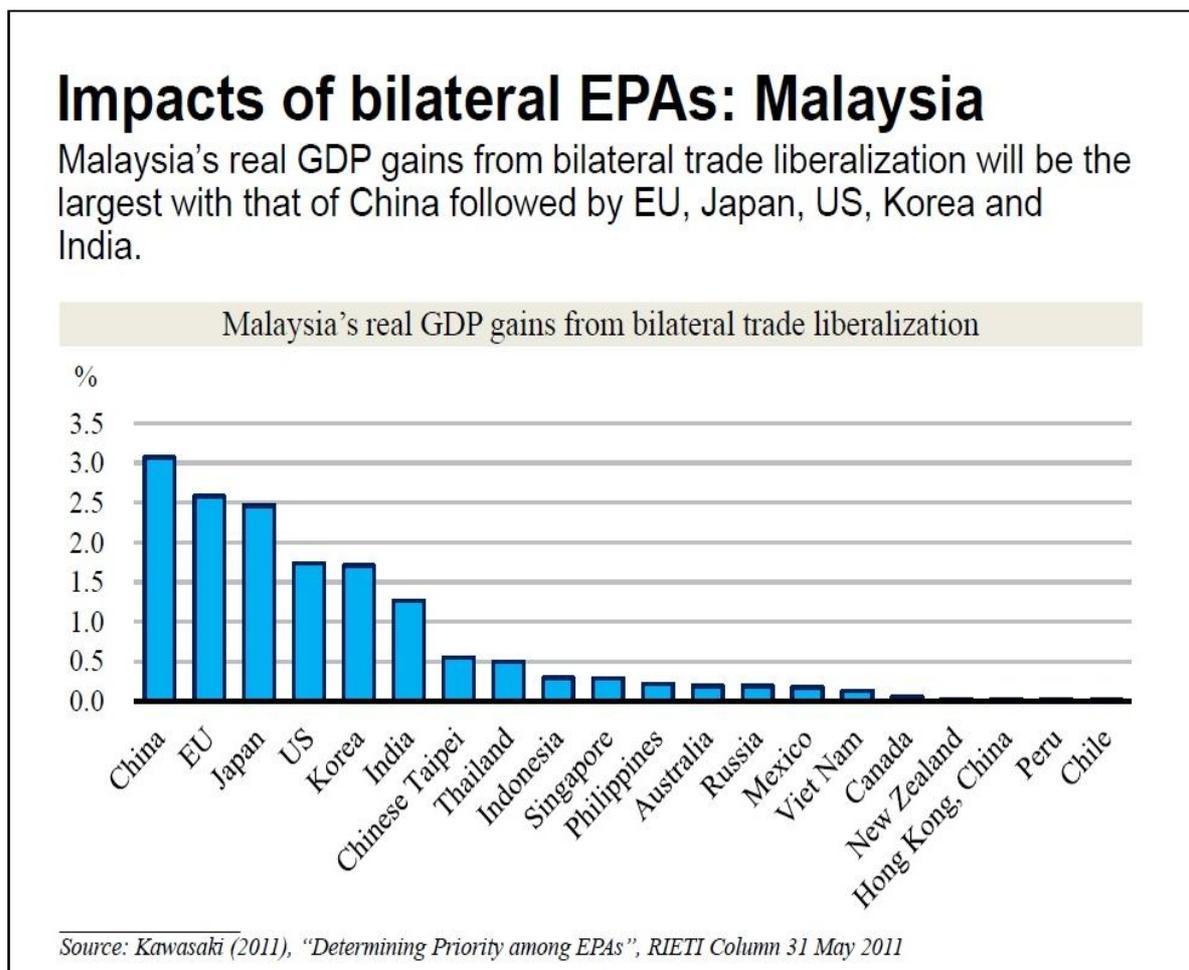
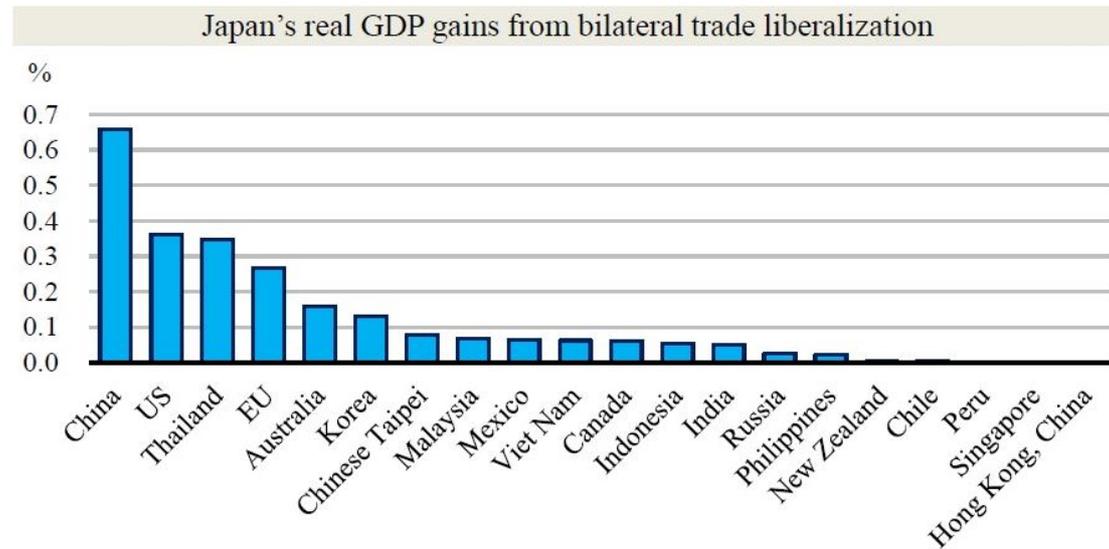


Figure 5

Impacts of bilateral EPAs: Japan

Japan's real GDP gains from bilateral trade liberalization will be the largest with that of China followed by US, Thailand and EU.



Source: Kawasaki (2011), "Determining Priority among EPAs", RIETI Column 31 May 2011

Figure 6