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AQ FEATURE

The Next Big Thing? The Trans-Pacific Partnership & Latin America

BY Barbara Kotschwar and Jeffrey J. Schott

Moving the Trans-Pacific Partnership into second gear.

The hottest topic in world trade these days is the Trans-Pacific Partnership (TPP). Hailed as a state-of-the-art free trade agreement (FTA), it will unite 11 countries—Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam—with a combined GDP of almost $21 trillion (about 30 percent of world GDP) and $4.4 trillion in exports of goods and services, or about a fifth of total world exports. If you add Japan and South Korea—who are actively exploring entry later this year—TPP would cover 40 percent of world GDP and nearly a third of world exports.

But as with any ambitious multilateral trade initiative, getting to the final goal won't be easy.

Many of the TPP participants already have FTAs with one another, and many have trade agreements with partners not expected to join the pact. In Latin America, some countries with existing strong trade ties across the Pacific are in the negotiations; others are not. TPP as currently conceived may also disrupt existing intra-American integration arrangements, with some countries and trade blocs left out entirely.

Such overlapping trade agreements and commitments among members and nonmembers represent one stumbling block to a deal. Another is determining who to let in and when. But if these issues are handled well, TPP will serve to update and expand existing pacts, as well as reinforce their integration into global supply chains. Equally important, TPP can help set the standard for trade reform not just for the Asia-Pacific region, but for the global trading system. Indeed, precedents developed in the TPP could become a foundation for new initiatives to revive the flagging multilateral trade talks in the World Trade Organization (WTO).

But if the various issues are not addressed thoroughly, or effectively, TPP will not only fail to live up to its potential; it could even sow political and economic discord.

The Trans-Pacific talks have been unique among modern trade negotiations. New members, most recently Canada and Mexico, have been allowed to join during the course of discussions. All current TPP members are members of the Asia Pacific Economic Cooperation (APEC) Forum,[1] a grouping of countries that includes Australia, Canada, Chile, China, Indonesia, Japan, Mexico, Peru, and the United States. Indeed, APEC membership has been an unofficial requirement for entry; TPP countries see their prospective accord as a key pathway toward APEC's long-standing goal to create a Free Trade Area of the Asia Pacific (FTAAP).

While TPP is designed to broaden and deepen trade and investment ties in the region, it has not pulled in all countries with FTAs. One major reason Canada and Mexico had to join was to avoid disrupting the deep integration of North American markets that has evolved since the establishment of the North American Free Trade Agreement (NAFTA).

But other FTA partners have been more cautious. The problem arises most prominently with two integration initiatives: the ASEAN, of which four of the ten members are not signatories of APEC, and the nascent Pacific Alliance (Chile, Colombia, Mexico, and Peru). The ASEAN issue is already being addressed in a parallel negotiation of a Regional Comprehensive Economic Partnership (RCEP), in which the ASEAN-10 are working together to deepen ties with their FTA partners in the region (those six countries are China, India, Japan, South Korea, Australia, and New Zealand).[2]

In the case of the Pacific Alliance, work is still proceeding to deepen ties with FTA partners in the Western Hemisphere, including the United States. While there is currently no common approach to negotiating with Asian countries, Pacific Alliance members are engaging with Asian economies: Chile and Peru have signed agreements with China and South Korea; Chile and Mexico have negotiated FTAs with Japan; and Colombia recently signed its FTA with South Korea and is in negotiations with Japan. Membership in TPP would offer a more coordinated path toward their goal of expanding ties with Asian markets.

The U.S. could help strengthen these efforts by supporting broader Latin American participation in the TPP. While adding new Latin American countries to the TPP talks is unlikely before the initial deal is cut, U.S. officials should help prepare other partners in the hemisphere for accession in the coming years. Such an effort should give priority to members of the Pacific Alliance, but should also reflect the U.S. interest in re-engaging Latin America more broadly—an interest that has been conspicuously on the back burner of U.S. foreign and economic policy for the past decade.

TABLE 1

Trade Indicators*, 2011

*Rounded : totals may not add up.

		GOODS		SERVICES	
Country	**GDP**	**Exports**	**Imports**	**Exports**	**Imports**
TPP-11 ($ billions)					
Australia	1,488	271	244	51	60
Brunei	16	19	11	1	2
Canada	1,737	452	462	76	101
Chile	248	81	74	13	14
Malaysia	279	227	188	36	38
Mexico	1,155	350	361	15	30
New Zealand	162	38	37	10	11
Peru	174	46	38	5	6
Singapore	260	410	366	125	111
United States	15,094	1,481	2,265	600	412
Vietnam	123	97	107	9	12
Subtotal	**20,736**	**3,470**	**4,153**	**940**	**796**
Prospective countries ($ billions)					
Japan	5,869	823	854	146	167
South Korea	1,116	555	524	95	99
Subtotal	6,985	1,378	1,378	241	266
Total (TPP-11 + prospective countries)	27,721	4,847	5,531	1,182	1,062
Perspective					
World ($b)	69,660	18,217	18,381	4,150	3,868
TPP-11 % of world trade	30	19	23	23	21
Prospective % of world trade	10	8	8	6	7
Total/world (percent)	**40**	**27**	**30**	**28**	**27**

Source: Schott, Kotschwar and Muir, Table 1.1

View expanded version of table.

Shifting Hemispheric Tradewinds

A decade since countries in the Americas began pursuing the creation

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of a Free Trade Area of the Americas (FTAA), regional trade policy has fractured. The effective demise of the FTAA occurred around the same time as the collapse of the Doha Development Round in the WTO in 2008. With both of the broad trade discussions effectively derailed, Latin Americans have focused on bilateral FTAs, many of them with the U.S., the EU and, increasingly, Asian countries. The U.S., after finally passing FTAs with Peru, Colombia and Panama, has set its sights across the Pacific and the Atlantic. On the Asia-Pacific side, TPP is the trade policy manifestation of the Asian pivot of U.S. policy. On the Atlantic side, U.S. plans for the Trans-Atlantic Trade and Investment Partnership (TTIP) with the European Union (EU) is its counterpart.

The fade-out of the FTAA has left in its wake a process of incremental focus and integration of the Pacific-oriented countries of the Americas. But it has had negative consequences as well. The once-promising Mercosur has taken a political—and protectionist—turn. The Andean Community has been plunged into an identity crisis with the withdrawal of Venezuela and with remaining members pursuing radically different trade policy paths.

On the Pacific front, Chile, Colombia, Mexico, and Peru have translated a shared approach to trade policy into the formation of the Pacific Alliance.[3] This initiative represents a formal effort to synchronize members' trade commitments, with the aim of using the Pacific Alliance as a platform for enhanced trade with their most dynamic trading partner—East Asia.

The Pacific Alliance already has a robust base of common trade agreements: all have signed free-trade agreements with one another as well as with the U.S., and they share a number of other overlapping trade commitments. **[See Table 2.]** This common hub of existing agreements should serve as a basis for deepening their integration, with the eventual goal of free movement of goods, services, capital, and persons.[4]

TABLE 2

Pacific Alliance Countries: Common FTA Partners

	Chile	Colombia	Mexico	Peru
Canada	A	A	A	A
United States	A	A	A	A
Mexico	A	A		A
Colombia	A		A	A
Peru	A	A	A	
Chile		A	A	A
Argentina	A	A		A
Bolivia		A	A	A
Brazil	A	A		A
Uruguay	A	A	A	A
Venezuela		A		B
Ecuador	A	A		A
Paraguay	A	A		A
Costa Rica	A	C	A	B
El Salvador	A	A	A	
Honduras	A	A	A	
Guatemala	A	A	A	
Nicaragua	A		A	
Panama	A	C		A
EU-27	A	B	A	B
EFTA	A	A	A	A
Turkey	A	C		
Brunei	A		C	C
China	A			
Japan	A	C	A	
South Korea	A	C	C	A
Malaysia	A		C	C
New Zealand	A		C	C
Singapore	A		C	A
Thailand	C			A
Vietnam	B		C	C

A = In effect; B = Signed; C = Under negotiation.

View expanded version of table.

In the decade before the initiation of the Pacific Alliance, trade among the member countries had grown dramatically. In 2000, the four future Alliance members exported 2 percent of their total exports to one another; in 2011, this doubled. The Pacific Alliance countries exported over $33 billion to China and $3.6

billion to ASEAN in 2011, compared to $2.5 billion in 2000. Whereas in 2000, the U.S. made up 77 percent of the export market, its share of Pacific Alliance exports fell to 58 percent in 2011. China and ASEAN's share grew to 7 percent from barely over 1 percent in 2000.

The initiative is open to expansion. Costa Rica and Panama have been observers since the beginning, and Costa Rica is close to signing with all members, one of the requirements of full membership. Uruguay and Guatemala were welcomed as observers, and a request from Paraguay is pending. The Pacific Alliance's potential has been underscored by extensive interest from outside the region: Australia, Canada, Japan, New Zealand, and Spain have signed on as observers.

Colombia is the only Pacific Alliance member not currently participating in TPP, but it is well-positioned to do so. Colombia had asked to be a member of APEC in 1995 (though it still is not) and has formally expressed interest in participating in the TPP. Colombia has free trade agreements with five of the 11 current TPP members. It also recently signed an FTA with South Korea and is in negotiations with Japan. The TPP-11 represent nearly half of Colombia's export market. The U.S. makes up the bulk of this, but the non-U.S. TPP market has been growing more dynamically, by an average of 26 percent per year over the past five years.

Central American countries are also bolstering their integration process, hoping to create a Mesoamerican corridor that will extend down the long-neglected Pacific Coast with a view to spurring trade ties to Asian markets. Central American integration received a boost with the negotiation of the CAFTA-DR free-trade agreement with the United States. The process required that Central American countries negotiate jointly, thereby forcing them to increase the compatibility of their trade policies (some already harmonized under the Central American Common Market) and to adopt a common position *vis-à-vis* the United States. In response, Mexico took the initiative of harmonizing its free-trade agreements with various Central American partners.

Central American countries also have stepped up their efforts to integrate with the world economy. As a bloc, they have signed a free-trade agreement with the European Union and are negotiating with the European Free Trade Association (EFTA). They also have free-trade agreements in place with Chile and Mexico. Subgroups have also climbed aboard the FTA bandwagon. The countries in the Northern Triangle (El Salvador, Guatemala and Honduras) have an FTA with Colombia. Recognizing the importance of trade with the East, Costa Rica has signed an FTA with China and Singapore. The other four members of CAFTA-DR have FTAs with Taiwan.

On the other side of the Americas, both geographically and ideologically, are Mercosur and Ecuador. Mercosur showed promise in the 1990s, reducing tariffs and other barriers to trade, forging a common trade policy and participating actively in the FTAA negotiations. Recently, politics has prevailed over economics and Mercosur countries have focused more on geostrategic efforts and internal politics.

During this time, following the denoument of the FTAA talks, Brazil has oriented more of its efforts toward the two so-called integration arrangements that explicitly exclude the U.S. and Canada: the Union of South American Nations (UNASUR) and the relatively new Community of Latin American and Caribbean States, CELAC, of which Cuban President Raúl Castro is currently the head. Mercosur has also focused more on expansion —adding Venezuela and Bolivia as full members—rather than on deepening or furthering liberalization. In fact, intra-Mercosur trade peaked 15 years ago, when exports within the bloc constituted about 25 percent of trade among its members. Intra-regional exports have fallen off since then, settling to around 15 percent over the past decade.

Mercosur countries have also been very active in using tariffs, taxes and other protectionist measures to protect their domestic economies. As a result, Mercosur now includes the first, second and fourth most protectionist countries in the Americas as measured by the number of protectionist measures employed in the past five years.

Argentina has been the most active, imposing tariffs on key exports, particularly meat, dairy products, wheat, and corn. The government has also applied quotas, non-automatic import licenses and "buy Argentina" requirements. According to Global Trade Alert, a website that tracks trade protection since the onset of the global economic crisis, Argentina has imposed 84 non-tariff measures and six tariff increases—including increases in Mercosur's common external tariffs on 100 industrial products.

Many of these measures are leveled at other Mercosur members, indicating a strong backlash, despite the 20-year process of economic integration, which is making the customs union's objectives increasingly untenable.

Mercosur, as a result, has not engaged in the type of trade expansion seen by the Pacific Alliance countries. Instead, it appears to have focused on reconfiguring its membership for political ends, rather than long-term gains in trade integration. It accepted Venezuela and Bolivia as full members and ejected Paraguay (which was blocking Venezuela's full membership in the customs union). Although Mercosur, heavily weighted by Brazil, makes up nearly 5 percent of world GDP, compared to the Pacific Alliance's nearly 3 percent, it underperforms in trade terms, comprising only 2.5 percent of world merchandise exports, compared to the Pacific Alliance's 2.9 percent.

After signing an FTA with the Andean Community in 2005, Mercosur seems to have decided to sit out the FTA race. It concluded an agreement with Israel in 2007 and an auto sector accord with Mexico—which two Mercosur members nearly abrogated last year. Agreements have been signed with Egypt and the South African Customs Union (SACU), but these have not entered into force. Negotiations with the EU, still one of mercosur's main export markets, have crawled along since 2000 without significant progress, although they were re-launched in 2010.

While China and East Asia have become increasingly significant trade partners, Mercosur countries have not consolidated those relations through FTAs. China now absorbs over 17 percent of Brazil's exports, outpacing the U.S., which buys only 10 percent. Mercosur only provides a market for 12 percent of Brazilian goods.

Instead, they have preferred to deal with China and other Asian countries bilaterally and on a case-by-case basis. In July 2012, for example, Brazil and China agreed to a $30 billion currency swap. At the same time, Brazil has raised tariffs against Chinese goods and accused China of manipulating its currency.

Three Scenarios; Three Outcomes

Given this trade landscape, how will the negotiation of the TPP affect Latin America?

We consider three plausible—and not mutually exclusive—scenarios.

The Status Quo Forward: TPP expands, but only to APEC members, while U.S.-EU negotiations for TTIP are launched in June. Multilateral negotiations remain stalled and large segments of Latin America continue to be left out of broader trade integration.

The Coalition of the Willing: The U.S. pushes for TPP entry for certain countries, starting with Colombia, Costa Rica and Panama. The negotiations with these more market- and trade-friendly economies further divides Latin America, rewarding some countries with eventual TPP membership and leaving others behind.

The Multilateral Booster: TPP, and the process of negotiating the TTIP, spark broader momentum at the multilateral level for free-trade discussions under the WTO, much as NAFTA did with the Uruguay Round talks.

The first scenario envisions the current TPP membership moving forward with no additional countries in the hemisphere joining. The three NAFTA partners, as well as Chile and Peru, are the only countries in the Americas to participate in a project that, if successful, may well rewrite the rules of the trading game. The remaining Pacific Alliance member, Colombia, will be left out, as will Costa Rica and Panama.

Under this scenario, the U.S. consolidates its pivot to the East with a concomitant effort to solidify its commercial partnership with Europe through the TTIP. Relations with Latin America remain on the foreign and economic policy back burners. Some focus will be oriented to the NAFTA partners as the TPP provides an opportunity to strengthen and modernize NAFTA, which has not been adjusted in light of the many changes in trade negotiations since 1994.

Relations with other Latin American countries will be mostly cordial, with occasional presidential summits, initiatives to exchange information and promote cooperation, but no significant commercial initiatives.

The second scenario anticipates more dynamism in the TPP. Under this scenario, the U.S. resumes a hemispheric approach and takes a leadership role in promoting entry by its Latin American trade partners. The TPP members are persuaded to move away from their unofficial APEC membership rule and welcome partners such as Colombia, Costa Rica and Panama. There is ample justification for this move. All these countries have liberal trade policies and have undertaken significant commitments in modern trade agreements, oriented their trade policies toward the Asia-Pacific region, and expressed interest in participating in the TPP. Developments on the other side of the Pacific could reinforce this approach if ASEAN members wish to also include ASEAN members that are not yet in APEC.

This scenario enforces the already emerging split between the Pacific Alliance and Mercosur.

The multilateral booster scenario sees super-regional trade negotiations such as the TPP and the TTIP, coupled with other initiatives among like-minded countries, such as the plurilateral International Services Agreement (ISA), in which WTO members may agree to new rules and market access commitments in the area of services, currently the most dynamic area of world trade,[5] as spurs to the multilateral trading system. In this scenario, the TPP will help build momentum for restarting WTO talks, which will benefit Latin American countries by providing a forum in which all members can participate in forging trade rules in a nondiscriminatory manner—the basis of the WTO.

Getting to Best

The third scenario is the best case. To get there, U.S. policymakers must take the lead in bringing Latin America, to the extent possible, back to the table. It has been eight years since the fourth Summit of the Americas meeting in Mar del Plata—which shut the door on efforts to craft a Free Trade Area of the Americas (FTAA).

The U.S. has scored notable achievements in hemispheric trade policy in the intervening years. It has signed free-trade agreements with specific partners, although it took far too long. However, Washington should not neglect important follow-up measures. It should encourage deeper integration among FTA partners and join in that process with them. One step has been taken with the NAFTA countries by encouraging TPP participation for Canada and Mexico. It is time to do the same for the other Latin American partners of U.S. FTAs. Finally, the U.S. should take the lead in encouraging other TPP member countries to drop the APEC requirement and welcome Colombia, Costa Rica, Panama, and others.

A major remaining challenge will be the U.S. relationship with Brazil. To mitigate the effects of dividing the hemisphere along trade policy lines, the U.S. and its FTA partners, as well as Brazil, must move to reconstruct multilateral negotiations. This would require a resolution to the Doha Round impasse, in which Brazil—not a party to any of the major trade initiatives—could play the deciding role. Hopefully, spurred by a regional movement toward FTAs in the Atlantic and the Pacific, Brazil will re-engage in the WTO.

If it does, the U.S. should follow suit and draw on precedents from its trade initiatives across the Atlantic and Pacific to help construct an ambitious and balanced trade deal that can strengthen world trade as well as hemispheric trade relations.

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FYI Peru has FTAs with Japan and China (implemented) and Guatemala (signed)

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  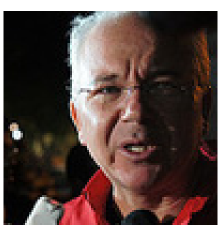

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