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Bridging the Pacific

The Americas' New Economic Frontier?

By Peter S. Rashish

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Foreword

The United States is currently negotiating two major trade agreements: the Trans-Pacific Partnership (TPP), involving Canada and ten Asian and Latin American countries; and the Transatlantic Trade and Investment Partnership (TTIP) with the 28-member European Union. If successfully concluded, these agreements will create stronger bonds between the US economy and fast-growing emerging economies, and between the United States and Europe, its top trading and investment partner.

The Atlantic Council is a leader in spreading awareness of TTIP and its potential advantages. From the beginning, we have viewed this transatlantic agreement not only as an economic game-changer, but also of great importance strategically.

But TTIP is only part of the picture. Over the past decade, while the US economy grew by 1.7 percent and the EU economy by 1.2 percent, Asia-Pacific grew by 9.2 percent—representing two-thirds of global growth—and Latin America has grown by 4.1 percent. The United States and the European Union have strong interests in building deeper economic ties with these two dynamic regions. TPP, by building a comprehensive economic platform between the United States and its Latin American and Asian partners, would be a significant step forward.

TPP could potentially link rapidly growing Asian markets with strong democracies in the Americas.

Latin America will play a central role in such an agreement. During the past few years, many countries in the region have been at the forefront of a wave of trade liberalization. Eleven Latin American countries have free-trade agreements (FTAs) with the United States, and ten have FTAs with Europe. The Pacific Alliance, an integration grouping that includes Chile, Colombia, Mexico, and Peru, is creating new export and investment opportunities and is yet another sign of a region that is largely becoming more outward-looking.

With these developments in mind, the Atlantic Council's Adrienne Arsht Latin America Center and Global Business and Economics Program have published this report, authored by Peter Rashish. The report launches the Council's work on TPP, exploring the agreement's potential to link up rapidly growing emerging markets in Asia with strong democracies across the Americas to create significant and sustainable economic growth across the Pacific. TPP should go beyond removing barriers to traditional trade in goods and services to tackle broader issues such as intellectual property rights, investment frameworks, and international regulatory cooperation.

Today is a critical moment. TPP and TTIP together encompass more than 60 percent of global GDP, so decisions made in these negotiations will define the rules of the road for future commerce globally. Participating countries, especially the United States and those from Latin America, have an important opportunity to shape the direction of global trade rules. They should seize it. This report lays out a path forward, with recommendations to policy leaders to ensure that TPP—with TTIP—meets that ambitious goal.

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Executive Summary

In a fast-changing global economy, the United States and Latin America are looking across the Pacific for partners to expand economic opportunity, create jobs and sustainable growth, and reinforce peace and prosperity across the region. The landmark Trans-Pacific Partnership (TPP) is an unmatched opportunity to bind these countries together. Today, however, the agreement's prospects are uncertain. Failure would constitute a serious geopolitical and commercial setback for both the United States and Latin America.

TPP began in 2004 as a modest but novel inter-regional effort by four countries on the Pacific Rim to liberalize trade and investment. Ten years later it has grown to twelve member countries that represent 40 percent of global GDP, 26 percent of global trade, and 40 percent of US trade. It is the first major "twenty-first-century" trade negotiation encompassing not only tariffs and quotas but also new areas like regulatory cooperation, competition policy, environment and labor, and trade in digital goods and services. With the dynamic growth of Asian economies, the impasse in the WTO Doha Round, and the rise of China, TPP has now acquired global significance for three distinct yet partially overlapping reasons: commercial opportunities, geoeconomics, and security policy.

Latin America's exports should become increasingly competitive in Asia-Pacific markets with an enabling trade-policy framework.

Along with the Transatlantic Trade and Investment Partnership (TTIP), TPP has become one pillar of a US policy objective to create broad backing for new rules of global economic governance. All participating countries have a strong stake in TPP's success, but should TPP fail, the challenge to Latin America would be particularly acute. The United States can look to the European Union via TTIP, and sixteen countries in Asia are in talks for a low-ambition but still politically important Regional Comprehensive Economic Partnership. Latin American countries—both TPP members and future ones—have no Plan B of this magnitude.

TPP's potential for Latin America is considerable. While the region's exports to the United States grew by 77 percent between 2000 and 2011, its exports to Asia jumped by a remarkable 590 percent. Asia is now Latin America's second-largest trading partner, after the United States and ahead of the European Union. Asia's catch-up in wages and living standards over the last decade means that Latin America's exports should become increasingly competitive in Asia-Pacific markets with an enabling trade-policy framework. Latin America should also become an increasingly attractive place for Asian multinationals to invest.

Latin America also benefits if TPP includes language that helps it take part in emerging Asian supply and value chains in manufacturing. For this to happen, TPP would have to make considerable progress in rationalizing the often divergent rules of origin in the over one hundred free-trade agreements (FTAs) that already exist in the Asia-Pacific region. If TPP includes liberal investment and services provisions, it could also help the region to diversify its exports to include more manufactured goods as well as finance and telecommunications.

Beyond opening new markets and setting the new rules of the road for the global economy, TPP will have significant security-policy implications. TPP's role to reassure US partners across the Asia-Pacific in the face of a rising China was built into the talks early on as part of the Obama administration's "pivot to Asia." Japan plays a key role in this equation. Japanese Prime Minister Shinzo Abe is strongly committed to pulling the country out of its deflationary trajectory.

A successful TPP would lead to increased opportunities for US and Latin American firms in the large Japanese market. More broadly, without the participation of a strong and outward-looking Japan—a country that shares many values and interests with the United States and most Latin American countries—TPP's role as a backstop to security-policy ambitions in Asia will fall short.

An overriding question the United States and Latin American countries need to ask is how to find common ground for engagement with China. China's model of state capitalism, its desire to be a provider of security in Asia through its contribution to "regional economic cooperation" and "peaceful development," and its unwillingness to adopt high-standard Western economic rules and principles must all be taken into account.

Given its recent actions in the East and South China Seas, admitting China now to TPP could send the wrong message. But TPP members and China would benefit greatly with China in the fold. Negotiating countries should find a way to invite China (and other desirable candidates) to join the talks as observers, and ultimately the agreement, assuming strong and effective conditionality.

Both the United States and Latin America would suffer major economic and diplomatic setbacks should TPP fail. The United States is the de facto TPP leader. By the end of 2014, the Obama administration needs to ensure that Congress passes the Trade Promotion Authority it needs to complete the talks. Part of that process will require the Senate Finance Committee to release a new draft TPA bill that can command bipartisan support.

The US public (but also some among the policy elites) is becoming restive and more skeptical of US international engagement. Without bold US advocacy about TPP's geoeconomic benefits—especially the risks to US prosperity and well-being from the rise of the state capitalism economic model—the debate will be captured by groups representing narrower political and economic interests. TPP discussions are already lumbering in that direction.

TPP also needs more geographical balance. Colombia, Costa Rica, Panama, and other interested countries in Latin America should be welcomed into the talks. To ensure that companies and consumers from all member countries can take advantage of supply and value chains across the Pacific, the agreement must rationalize the "spaghetti bowl" of rules of origin and not end up as a collection of overlapping bilateral deals.

Demands are growing for more transparency in TPP talks. The TPP negotiating process should be made more transparent without sacrificing the confidentiality that characterizes all international negotiations, and its goals should be communicated more clearly.

TPP's inclusion of new issues like regulatory cooperation has given rise to a debate about its impact on participating governments' ability to maintain high levels of consumer, health, and environmental protections. A major goal of US trade policy under President Obama, including TPP, has been to defend and even strengthen already-high US standards. This process should continue as trade agreements offer a powerful platform to build upon and extend these hard-fought protections both at home and abroad.

Connecting Commerce, Geoeconomics, and Security

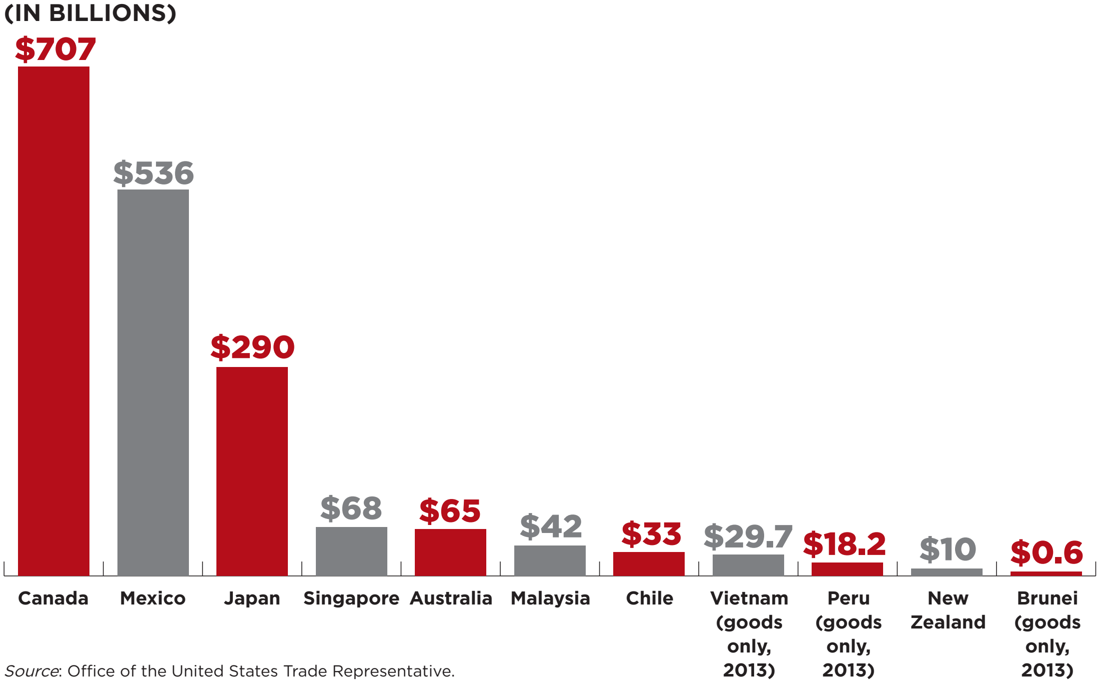
The Trans-Pacific Partnership (TPP) began as a modest but novel effort by four countries—Brunei, Chile, New Zealand, and Singapore—with very little in common beyond their location on the Pacific Rim, to liberalize trade and investment among themselves. Over time, this experiment in Asia-Latin America economic integration gained considerable traction.

Now, the United States and Japan—the first- and fourth-largest economies in the world—as well as Canada, Mexico, and Peru in the Americas and Australia, Malaysia, and Vietnam in Asia have joined the four founding TPP members to negotiate a mega-regional FTA with an unprecedented level of ambition for trade, investment, and economic integration.[1] For the United States, TPP would expand trade relationships with a growing set of important partners [See Figure 1].

As TPP has gained momentum, it has not left the broader chessboard of international trade unaffected. In 2013, the United States and the European Union launched their own mega-regional deal, the Transatlantic Trade and Investment Partnership (TTIP), to respond to many of the same concerns that gave rise to TPP. Rather than providing competition for TPP, the existence of TTIP has raised the stakes for TPP, accentuating its geoeconomic and security policy consequences.

FIGURE 1. The United States: Deeply Connected to TPP Countries

US TRADE IN GOODS AND SERVICES WITH TPP COUNTRIES, 2012 (IN BILLIONS)



Source: Office of the United States Trade Representative.

TPP should now properly be seen as the Pacific leg of a major US policy objective to create a majority consensus for new rules of global economic governance, with TTIP as the Atlantic leg. If the twelve members of TPP cannot find enough common ground to seal the deal, the consequences would reach far beyond the Asia-Pacific region.[2] The pressure would intensify on TTIP, as it alone would carry the burden of creating twenty-first-century rules. Consequences of failure are real and should not be underestimated.

The challenges for Latin America would be particularly acute. While several Asian countries are negotiating a separate (and much less ambitious) Regional Comprehensive Economic Partnership (RCEP), Latin America's current (and future) TPP countries would have no mega-regional Plan B with TPP failure.

Some would try to join TTIP as a way to access new (but slow-growing) US and EU markets, assuming the United States and the European Union opened the talks to others after completion. Even if there were no political hurdles to the TTIP option, the practical challenges would be considerable given TTIP's high standards and regulatory commitments that most Latin American economies would have difficulty conforming with in the short term. Others would seek new bilateral FTAs across the Pacific to stay engaged with—and take advantage of—dynamic growth in Asia.

But rather than facilitating the participation of Latin American companies in trans-Pacific supply and value chains, more bilateral trade agreements could actually increase the complexity of Asia-Pacific trade and investment with the proliferation of competing rules of origin. The failure of TPP would deal a blow to both US security policy interests in Asia and its long-term objective of building a new governance model for the global economy. But in purely commercial terms, arguably no other region of the world has as much at stake in TPP's success as Latin America.

Latin America: Tapping into the Asian Growth Engine

While Latin America still trades more with the United States than with Asia, regional trade with Asia has overtaken Europe to occupy second place among Latin America's commercial partners. Latin America's exports to the United States rose from $196 billion in 2000 to $346.7 billion in 2011—a growth rate of 77 percent. During the same period, Latin America's exports to Asia leapt from $16.5 billion to $144.5 billion—a remarkable 590 percent growth rate.[3] Latin America's trade (exports and imports) with Asia is 21 percent of its total trade; the United States accounts for 34 percent of trade, and the European Union, 13 percent. At the same time, Latin America has doubled its share of Asia's total trade in the last ten years from 2.2 to 4.4 percent.[4]

An important element of Asia's economic and commercial rise for Latin America is the ongoing convergence in standards of living in the two regions. Between 2000 and 2011, Asian wages grew by 95 percent to become closer to Latin American levels, where wages increased by 15 percent (and by 5 percent in developed economies).[5] A similar trend exists in average incomes. While per capita income in Asia was around $1,000 in 1980, and $8,000 in Latin America, by 2010 the figure had risen to $7,700 in Asia and $9,700 in Latin America.[6]

This Asian catch-up means that Latin America's exports should become increasingly competitive in world markets vis-à-vis those from Asia, and that Asian consumers could become a more attractive target group for those exports. As Asian workers lose their wage advantages, it also means that Latin America should become an increasingly profitable place for Asian multinationals to invest, not only in traditional areas like commodities but also in manufacturing.

The Trans-Pacific Partnership: Economic Integration Across the Pacific

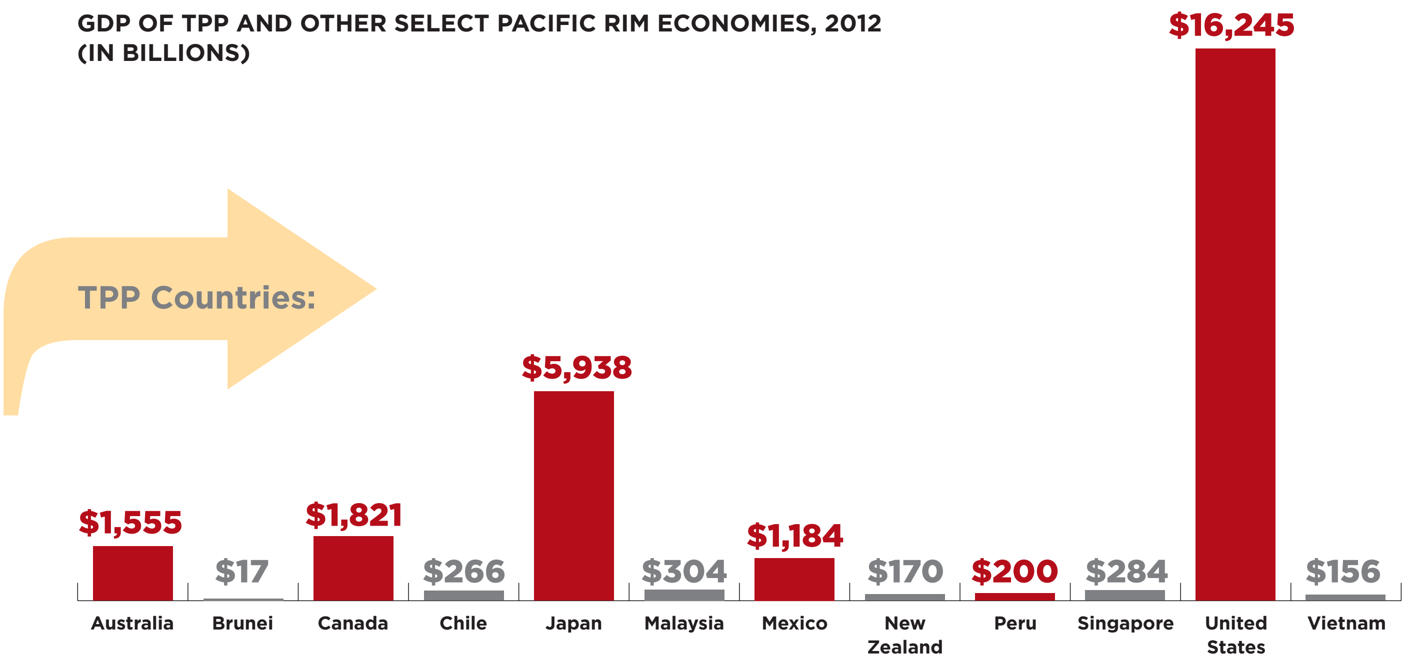
TPP is the principal avenue for advancing trade and investment liberalization and broader economic integration among the diverse Pacific Rim countries. The twelve countries negotiating the Trans-Pacific Partnership represent 40 percent of global GDP, 26 percent of global trade, and 40 percent of US trade [See Figure 2]. That makes it almost as significant as TTIP, which accounts for 46 percent of global GDP and 30 percent of global trade.

While TPP has always included an accession clause allowing other countries to join, the working assumption has been that only APEC (Asia-Pacific Economic Cooperation forum) members are eligible to join. Whether TPP will loosen its APEC membership prerequisite will be an important factor as additional Latin American countries like Colombia or Costa Rica consider joining.

TPP is a forward-looking regional agreement that in many ways is more ambitious than both the Doha Round and what most FTAs have covered historically. A successful negotiation will require participating states to align a large number of rules governing how their economies operate both domestically and abroad.

On the negotiating table are twenty-nine chapters that encompass traditional market access via elimination of tariffs and quotas, as well as new measures such as regulatory cooperation to reduce costs and inefficiencies (but not levels of consumer protection). Also on the table are provisions to help small- and medium-size companies benefit from trade, promotion of trade and investment in green and digital goods and services, environmental and labor rights protections, and high sanitary and phytosanitary (SPS) standards to improve animal and plant health and safety. Intellectual property protections to reward innovation and enhanced competition policy rules to ensure a level playing

FIGURE 2. TPP Countries Represent 40 Percent of Global GDP



field for private and state-owned companies are also under discussion.[7]

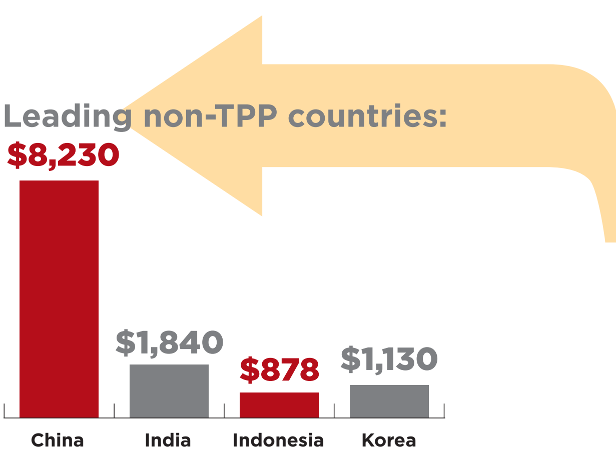
Rules of the Road: Forging a Twenty-First-Century Agreement

Because of its strong focus on rules, and given the economic heft of its twelve member countries, TPP—like TTIP—moves well beyond the purely commercial sphere and into the realm of geoeconomics. One of the leading rationales for the United States to join TPP—and to push for it to encompass the full set of provisions of a twenty-first-century trade agreement—was the WTO Doha Round's failure to provide a framework for high-standard rules of the road for the global economy. While Chile's decision to participate as a founding member of TPP in 2004 was motivated by commercial considerations, TPP has since become—as well as for Peru and Mexico, which joined later—a vehicle to help cement the free-trade and free-market reforms the country has recently implemented.

The world trading system has grown considerably more diverse in recent years. The so-called "Quad" economies (the United States, European Union, Japan, and Canada) that drove trade deals in the past must now share the stage with large, emerging economies such as the BRICS (Brazil, Russia, India, China, and South Africa). The increased leverage of the BRICS in global negotiations has made it difficult for the Quad to create general trade consensus. This becomes problematic given WTO rules that require unanimity for progress at the multilateral level. While the BRICS are hardly homogeneous, they and several other like-minded countries have tended to favor a model that gives the state more of a role to intervene in the domestic economy.

The vast majority (but not all) of the countries taking part in TPP prefer a free-market, rules-based approach to trade, investment, competition, and innovation. Only Brunei, Malaysia, and Vietnam, to varying degrees, maintain a significant policy or ownership role for the state in the operation of the economy. As a result, the United States sees TPP as an important building block—along with TTIP and the plurilateral Trade in Services Agreement (TiSA)—of its global strategy to create a critical mass of countries that support its geoeconomic objectives. Once these two large blocs of countries (TPP plus TTIP), which account for 60 percent of the global economy, agree on a set of ambitious and market-based rules and regulations, it will be more likely that others—most importantly, China—will be willing to come to the table at the WTO in Geneva. TPP and TTIP are two prominent elements of US international economic policy's "creative destruction" to "disrupt local oligarchies and global autocracies"and its creative construction of a more favorable environment for the flow of international commerce.[8]

Beyond geoeconomics and global economic



Source: International Monetary Fund.

governance, TPP is a reflection of US security policy. Negotiations are not taking place within a strategic vacuum. A strategic linkage exists between US and Japanese enthusiasm for TPP and, for example, the commitment of new US troops to Australia, new access for US ships to Philippine naval bases, or Japan's June 2014 decision to shed its ban on collective defense participation. All are elements of a strategy to respond to China's rising role in Asia.

Responding to a Rising China

A June 2014 poll of the United States and ten Asian countries conveys a clear picture of the differing economic and security realities in Asia. An average of 53 percent of respondents said China will exert the greatest power in East Asia in ten years, followed by the United States with 43 percent. Similarly, 56 percent of respondents expect China to be their country's most important economic partner in ten years, followed by the United States at 28 percent. While 79 percent of those polled considered China's impact on regional economic development to be either very or slightly positive, 61 percent felt China is having a very or somewhat negative impact on regional security.[9]

TPP's role to reassure partners across Asia-Pacific—five of which are US treaty allies—was built into the talks from an early stage. In this way, it is different from TTIP. Russian annexation of Crimea and its ongoing challenge to Ukrainian sovereignty in the east of the country has provided TTIP with an ex post facto rationale as a reinforcement of transatlantic ties in the face of a common security challenge.

While the economic opportunities from TPP are considerable, the talks have gained impetus with the desire of many Asian countries to balance their relationships with China and the United States. China's recent provocative actions in both the East China and South China Seas have unsettled several smaller countries and reinforced the perception that TPP is an essential part of the Obama administration's "pivot to Asia."

Japan's entry into TPP is particularly significant in this context. US-Japanese relations are at a nearly all-time high. Japanese Prime Minister Shinzo Abe is strongly committed to pulling the country out of its deflationary trajectory through the three arrows of "Abenomics": monetary easing, a fiscal boost, and domestic reform. An integral element of the third arrow is to raise Japan's trade covered by FTAs from 20 percent to 70 percent by 2018. If Abe's decision to join TPP leads to a significant opening of Japan's protected sectors (including agriculture and automobiles) and the easing of non-tariff barriers, US and Latin American firms would benefit from new opportunities to sell to and invest in the sizable Japanese market. Japan is still the world's fourth-largest economy. From a geostrategic perspective, without a strong, growing, and outward-looking Japan—a country that shares many values and interests with the United States (and most Latin American countries)—the US pivot to Asia will never fully bear fruit.

The United States sees TPP as an important building block of its global strategy to create a critical mass of countries that support its geoeconomic objectives.

Alongside TPP another multi-regional negotiation is competing for trade policy leadership in Asia: the Regional

Comprehensive Economic Partnership (RCEP). RCEP, which has much more modest ambitions than TPP, involves the ten countries of the Association of South-East Asian Nations (ASEAN) and their six free-trade partners.

Will the existence of these two parallel tracks—TPP and RCEP—lead to competition in Asia-Pacific between a US-led TPP and a Chinese-led RCEP? Although still a long way off, the answer may be provided by the mooted Free Trade Area of the Asia-Pacific (FTAAP). In its most expansive form, the FTAAP could cover all twenty-one members of APEC, including the four major regional economic powers—China, Russia, India, and the United States. The FTAAP idea was given impetus in 2004 by the APEC Business Advisory Council. Assuming TPP reaches a successful conclusion in the near future, China and India will not wish to be left out of such a dynamic framework for Asia-Pacific economic integration. While integrating TPP and RCEP would require deft diplomacy, FTAAP may hold out the prospect for reaching common ground between the two largest Pacific economic and security powers, the United States and China.

Assuming TPP reaches a successful conclusion, China and India will not wish to be left out of such a dynamic framework for Asia-Pacific economic integration.

Latin America and Asia-Pacific Strategic Concerns

How does Latin America fit into this broad strategic outlook? Chile was one of the four original members of TPP, certainly not out of any concerns about its security, but rather to tap into growing Asian markets for commodity and agricultural exports. The same is true about Peru's decision to join later.

Mexico's entry in 2012 in tandem with Canada was somewhat different and helped to raise the stakes of the TPP endeavor considerably. Mexico's deep trade ties with both the United States and Canada through the North American Free Trade Agreement (NAFTA) and its Pacific Alliance partners (Chile, Colombia, and Peru), as well as FTAs with Japan and the EU, suggest it has much at stake in the geoeconomic outcomes of TPP. Mexican President Enrique Peña Nieto is leading a series of reforms to the economy that clearly aim to cement the country's reputation for open, market-based, free-trade oriented rules and norms. TPP is a strong external anchor to these policies, and Mexico's participation in the negotiations adds a strong voice in favor of the liberal internationalist economic agenda also pursued by the United States.

In Latin America, Chile, Mexico, Argentina, and Brazil (which account for 80 percent of Latin America's trade with Asia) have for the most part developed a mutually beneficial commercial relationship with China, Japan, Korea, and India (which add up to 90 percent of Latin America's trade in Asia), principally through the classic operation of comparative advantage as they export raw materials in return for manufactured imports. There is every reason to believe that these important trading relationships will continue to intensify and act as a counterweight to competition in the security sphere.

Solving The Asia-Pacific Trade Policy Puzzle

There are already well over a hundred FTAs signed and in effect among the thirty-two Asia-Pacific countries. Both Asian and Latin American countries have exhibited considerable policy activism in the last decade on the FTA front. Most of these agreements are bilateral, but others, like the ASEAN FTA, NAFTA, and Central America's many FTAs with other countries of the hemisphere involve groups of countries; the result is a complicated web of FTAs [See Figure 3, p. 12].

In addition to those already in force, a number of FTA negotiations continue. Despite recent territorial frictions, China, Japan, and South Korea have been negotiating an agreement since 2012 and also maintain a parallel Trilateral Cooperation Secretariat to promote closer relations across a range of political and economic issues. China is negotiating separate bilateral FTAs with Australia, India, and South Korea, while Korea is in talks aimed at FTAs with Australia, New Zealand, China, Japan, Indonesia, and Vietnam.

TPP can bring some order to the plethora of FTAs that define the Asia-Pacific region.

Rationalizing Rules of Origin: From Spaghetti Bowl to Lasagna Dish

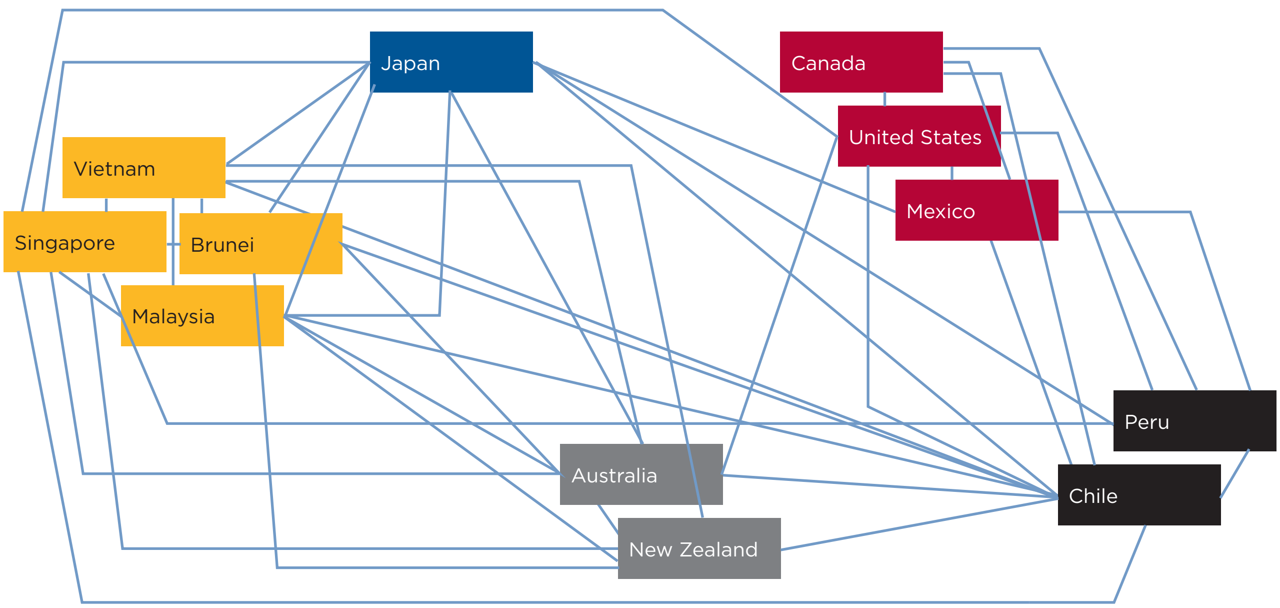
While these existing FTAs have certainly led to increased trade, their overlapping and not always mutually reinforcing provisions have created a "spaghetti bowl" of bilateral and regional agreements. This presents a challenge both to policymakers and to businesses trying to navigate various tariffs, quotas, rules, and regulations.

For example, Chile already has agreements with all of its TPP partners, including an FTA with Singapore. Peru also has an FTA with Singapore, and both Chile and Peru have FTAs with Japan. Imagine the hypothetical case of a company that produces in Peru, adds value and ships from Chile, then docks in Singapore—where the company further adds value to the finished product before it reaches Japan, the final destination (Japan and Singapore have their own FTA). Although all four countries involved—Peru, Chile, Singapore, and Japan—have FTAs among themselves, the task for this exporter is highly complex. And it will remain so until these countries conclude regional trade pacts such as TPP that can bring some order to the plethora of FTAs that define the Asia-Pacific region—to turn the spaghetti bowl of smaller, uncoordinated bilateral agreements into a "lasagna dish" of fewer, larger regional agreements.

Most challenging of all is to determine the product's country of origin as it makes its way along the two shores of the Pacific. While Peru may consider the origin Chilean, Singaporean authorities may see it as having Peruvian origin depending on how much transformation it undergoes in Peru. But Japan may have entirely different rules of origin (ROOs) from Singapore in its FTAs with Peru and Chile and may decide to brand the product as

FIGURE 3. The Complicated Constellation of Trans-Pacific Trade Agreements

Free-Trade Agreements Among TPP Member States



Existing Free-Trade Agreements

	Australia	Brunei	Canada	Chile	Japan	Malaysia	Mexico	New Zealand	Peru	Singapore	United States	Vietnam
Japan	●*	●		●		●	●		●	●		●
Brunei	●			●	●	●		●		●		●
Malaysia	●	●		●	●			●		●		●
Singapore	●	●		●	●	●		●	●		●	●
Vietnam	●	●		●	●	●		●		●		
Australia		●		●	●*	●		●		●	●	●
New Zealand	●	●		●		●				●		●
Canada				●			●		●		●	
Mexico			●	●	●				●		●	
United States	●		●	●			●		●	●		
Chile	●	●	●		●	●	●	●	●	●	●	●
Peru			●	●	●		●			●	●	

*Signed in April 2014, but not yet in effect.

Source: "The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress," Congressional Research Service, December 2013.

Chilean. Depending on these ROOs, the Chilean exporter could pay higher or lower custom duties as the product enters the Japanese market.

Latin America must increase its role in the emerging Asian supply and value chains in manufacturing.

In principle, this panoply of free-trade agreements should be an extra incentive to export for the Peruvian producer. But not all companies have the time or resources to determine which of the several rules of origin may apply to an exported product. Instead, the existing spaghetti bowl of FTAs could, perversely, act as a deterrent to exporting, or at the very least make such an activity unnecessarily costly. Conflicting rules of origin are undoubtedly creating several jobs in the legal sector of each economy, but they are not necessarily making trade or investment easier between partner nations.

Where does Latin America fit into this vivid but complex puzzle of economic integration across the Pacific?

Chile was among the trade-policy avant-garde when it joined with New Zealand, Singapore, and Brunei—the "Pacific Four" or P4—that launched TPP's forerunner, the Trans-Pacific Strategic Economic Partnership, in 2004. Concluded in 2006, this was the first trade agreement that brought Asia together with Latin America. The P4 agreement was not only innovative in its geographic reach; it also has a strong claim to being the first twenty-first-century agreement. It includes provisions covering trade goods and services but also government procurement, intellectual property rights, competition policy, and cooperation on labor and environmental issues.

While Chile, with its seven FTAs with countries across the Pacific (P4, Australia, China, Japan, Korea, Malaysia, and Vietnam) is the leader in Latin America, several other countries in the region have been active in trade liberalization across the Pacific. Peru has five FTAs in effect (China, Japan, Korea, Thailand, and Singapore) and Costa Rica has two (China and Singapore), as does Panama (Taiwan and Singapore). El Salvador, Guatemala, Honduras, Nicaragua (all with Taiwan), and Mexico (Japan) each have one.

One notable aspect of Latin America's FTAs is that all are with APEC member countries. Since 1989, APEC has taken a leading role in promoting economic development across the Pacific—not only through trade and investment liberalization but also via the more informal routes of business facilitation and technical cooperation. Not surprisingly given their early trade policy activism, Chile and Peru are both APEC members, and Costa Rica and Panama—each with two FTAs with Asian economies—have expressed interest in joining.

Promoting Latin America Interests: Value Chains, Commodities Trade, and Services

Latin America has a strong interest in the direction that trade liberalization and integration take across the Pacific for at least three key reasons. First, Latin America needs to increase its role in the emerging Asian supply and value chains in manufacturing. While geography does pose limits to the degree to which Latin American economies can tie into Asian production networks, there is clearly room to grow. This is all the more true as converging wages between Asia and Latin America can increase the competitiveness of Latin America's manufacturing exports—whether intermediate inputs or finished products—to Asia. Free-trade agreements—particularly ones with favorable rules of origins for Latin American producers—can play a role to promote this objective.

Second, Latin America has developed a mutually beneficial trade pattern with China and other Asian countries based on the exchange of mined goods and energy products for manufactured goods. While it is reasonable for Latin America to try to diversify the basis of its trading relationships with Asia, it also has to ensure that FTAs maintain this profitable flow of export income.

Finally, if Latin America is to move beyond the dominance of raw materials in its exports to Asia, manufacturing as well as services such as banking and telecommunications should be promoted. A number of globally successful "multilatinas" (Latin American-based multinational companies) like Itaú Unibanco and América Móvil already exist. To take full advantage of these companies' potential, the region will want to ensure that future FTAs in Asia-Pacific contain liberal provisions regarding both investment and the Mode III delivery of services involving commercial presence as set out in the General Agreement on Trade in Services.

Latin America's current and future trade agreements with its Asian partners are the most immediate and direct avenue to promote commercial interests across the Pacific, but other opportunities exist. The Pacific Alliance—an agreement established in 2012 among Mexico, Colombia, Chile, and Peru for the flow of trade, investment, people, and foreign commercial diplomacy—is also a major feature of the Asia-Pacific economic landscape. Members of the Alliance together account for 35 percent of overall Latin American GDP and half of the region's trade, and are part of FTAs with countries that make up nearly 75 percent of the global economy. These include partners that are among the largest, fastest-growing economies as well as leaders in trade policy, such as China, the United States, the European Union, and Japan. All four Alliance members are also participating in the plurilateral Trade in Services Agreement (TiSA) currently taking place in Geneva that is outside the WTO framework but is seen as potentially setting the terms for future multilateral discussions.

The Pacific Alliance is open to expansion (Costa Rica and Panama are likely future members), and an additional thirty countries have observer status, including the United States, China, India, Japan, and Turkey. Should the TPP fail to be be completed in the near term, an expanded Pacific Alliance offers Latin America its single most effective platform for home-grown trade policy leadership, for example as a partner in one or more cross-Pacific FTAs with Asian economies.

The Trans-Pacific Partnership: Who Benefits?

Latin America faces both the Pacific and the Atlantic. Many of its economies have developed strong ties with both the United States (Mexico through NAFTA, for example) and the European Union (Brazil and Argentina), but recent trade policies have been preponderantly oriented toward the fast-growing Asian economies. Asia is the number two trading partner for Latin America behind the United States and ahead of the European Union. Asia is Latin America's fastest-growing trade partner at roughly 20 percent per year over the last decade.

Not all of Latin America's Pacific-facing countries have taken full advantage of these opportunities in Asia. While Chile has seven Asian FTAs, Colombia and Ecuador have none. Nonetheless, as a group, the Pacific countries of Latin America have already concluded seventeen FTAs with Asian partners.

Asia is Latin America's fastest-growing trade partner at roughly 20 percent per year over the last decade.

Because of their differing resource endowments and industrial profiles, the three Latin American TPP countries have diverging trade patterns with key Asian economies and can expect different kinds of gains from TPP [See Figure 4, p. 16].

Asia is an important market for Chile, which exports large quantities of minerals and agriculture. In 2013, it traded $35.9 billion in goods with China, its single-largest trading partner in the world, posting a surplus of $3.5 billion, or 10 percent of its total trade with China. Similarly, Chile had merchandise trade worth $10.1 billion with Japan, its fourth-largest trading partner, with a surplus of $5.2 billion, or 5.1 percent of its bilateral trade. Trade with Korea, its sixth-largest trading partner, was $7 billion with a surplus of $1.5 billion, or 4.6 percent of its trade. Chile's exports are expected to grow by 2.5 percent under TPP—certainly a welcome increase, but given both its many current FTAs and the strong existing demand for its commodities exports in Asia, it will benefit from TPP less than the other two Latin American countries in the negotiations.

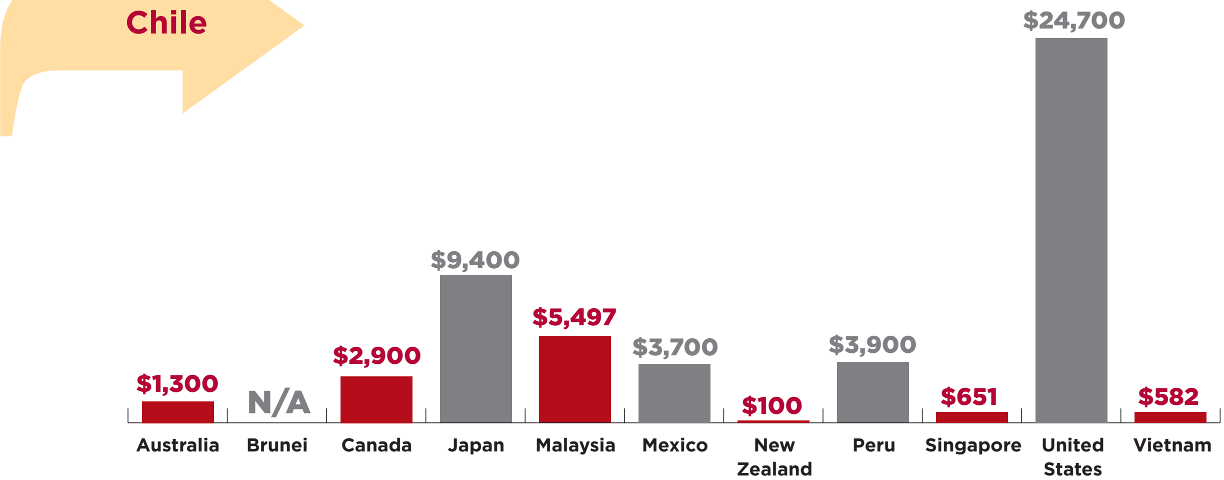
Mexico, which does not possess the mineral wealth that Asian economies need, has a distinctly different set of trading relationships. With China, Mexico's second-largest trading partner, its exports totaled $4.4 billion in 2013, but overwhelmingly larger imports of $48.7 billion made it run a trade deficit of $44.3 billion equal to 83 percent of its total trade with China. With Korea, its sixth-largest trading partner, it had exports of $1.3 billion and imports of $11.4 billion for a trade deficit of $10.1 billion, or 79 percent of its bilateral trade. With Japan, its fourth-largest trading partner, Mexico had imports of $15.1 billion and exports of $2 billion for a deficit of $13.1 billion, or 76 percent of bilateral trade.

Not surprisingly, membership in TPP would boost Mexico's exports by 6.2 percent given the new markets it would create for its industrial manufactured goods, especially in Japan where it could expect much greater liberalization compared to the terms of its now ten-year-old FTA with Japan.[10]

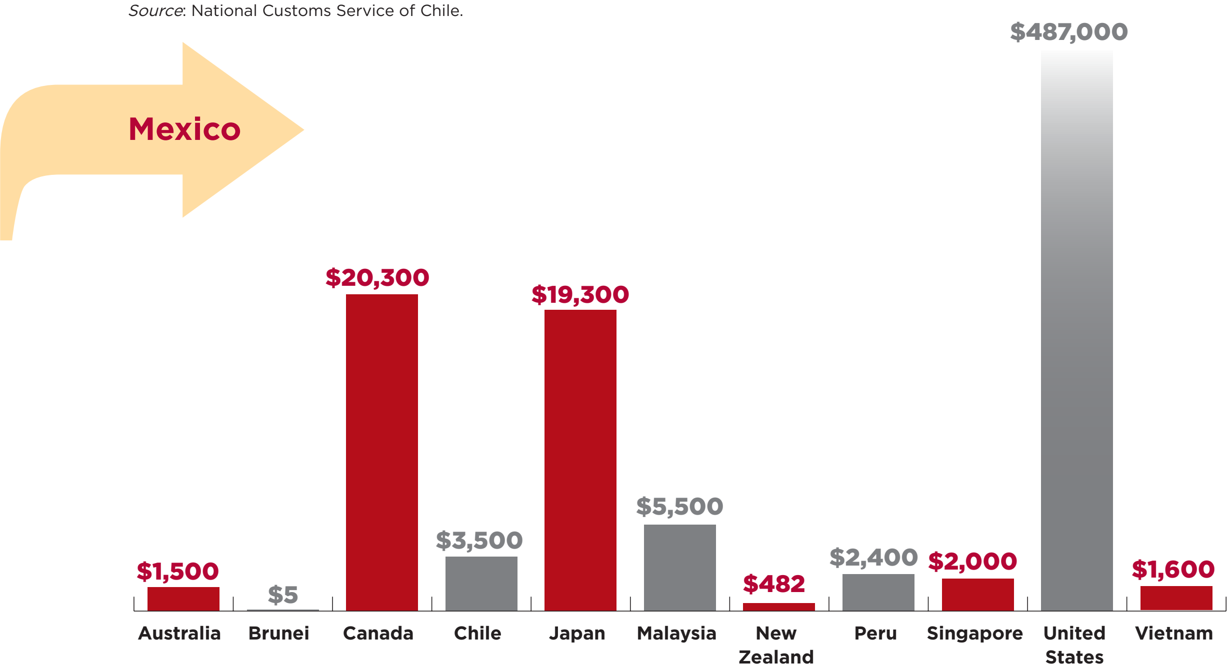
Peru is also a major exporter of commodities

FIGURE 4. Latin American Trade with Fellow TPP Countries

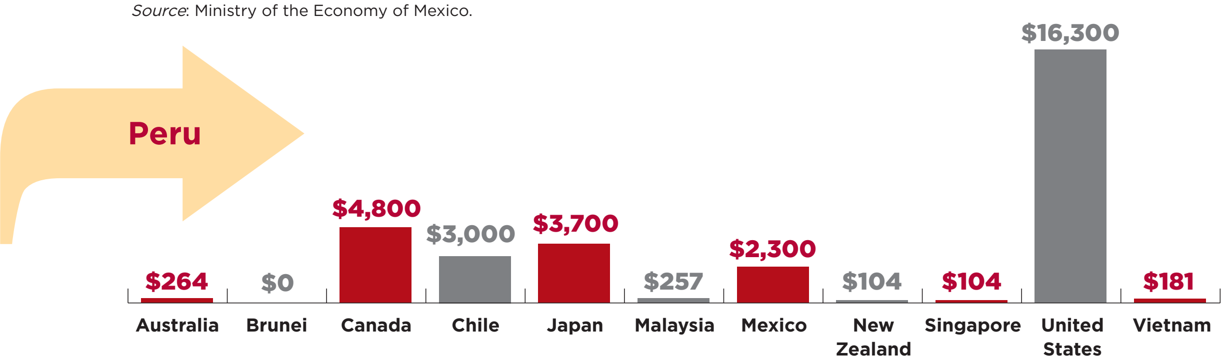
CHILE, MEXICO, AND PERU GOODS TRADE WITH TPP COUNTRIES, 2013 (IN MILLIONS)



Source: National Customs Service of Chile.



Source: Ministry of the Economy of Mexico.



Source: Ministry of Foreign Trade and Tourism of Peru.

to Asia. China is its second-largest trading partner, where it exported $6.1 billion in 2013 and imported $4.6 billion with a trade surplus of $1.4 billion, or 13 percent of its bilateral trade. Japan is it eighth-largest partner. Peru exports $2 billion and imports $889 billion, a trade surplus of $1.1 billion, or 38 percent of its trade with Japan. Korea is its ninth-largest trading partner, where it exports $1.2 billion and imports $1.3 billion for a small deficit of $100 million, or 4 percent of total trade. Peru's exports are expected to increase by a healthy 7.1 percent through TPP, mainly because of new access to Australia, New Zealand, Malaysia, and Vietnam—countries with which it does not have FTAs.[11]

Bridging Latin America's Pacific and Atlantic Economies

If and when others are invited to join TPP, Costa Rica, Colombia, and Panama are likely to be given priority because of their geography and their market-oriented economic policies. All three countries run trade deficits with China, Japan, and Korea, and as none has a developed web of FTAs with Asian economies, these countries could be expected to benefit considerably from membership in TPP.

One noteworthy fact is that outside of the region's Pacific countries, Latin America has only a single FTA with Asia: the Mercosur-India agreement that came into effect in 2009. In general, Mercosur—Brazil, Argentina, Paraguay, Uruguay, and Venezuela—has been remarkably absent as a trade-policy actor from the dynamic economies in Asia.

Outside of the region's Pacific countries, Latin America has only a single FTA with Asia.

Brazil and Argentina are relative newcomers to the FTA playing field, and, for the moment, their priority lies in moving forward on the long-stalled but now revived Mercosur negotiations with the European Union for a regional trade and cooperation agreement. The European Union is the number one trade and investment partner for Mercosur, and Brazil, in particular, has the ambition to increase its already respectable share of higher value-added exports to Europe. Brazilian or Argentine membership in TPP is far off at best; more likely would be Mercosur launching talks with the United States. Brazil and Argentina have much more to fear from losing privileged access to US and EU agricultural markets as a result of TTIP than from being excluded from TPP.

The United States and Japan: A Crucial TPP Nexus

TPP is an attempt to create twenty-first-century trade rules with an economically mixed group of countries, some of which are advanced industrial countries (such as Japan and Canada), and others are developing countries (such as Vietnam). The entry of Japan into TPP was not just an enlargement in its size; it extends the scope and purpose of the negotiation.

In addition to creating a twenty-first-century consensus on new rules of the road for trade and investment, TPP now also becomes a major opportunity for the United States to negotiate lower tariff and non-tariff barriers with its fourth-largest bilateral trading partner. Unlike Chile, Peru, and Mexico, the United States has no FTA with Japan. Because of the assumed reductions of Japan's trade barriers under TPP, by 2025 the United States' income gains could jump from $23.9 billion under a TPP-11 agreement to $76.6 billion under a TPP-12 agreement with Japan. US exports could rise from

$54.8 billion with TPP-11 to $123.5 billion with TPP-12, growing 1.9 percent under TPP-11 but 4.4 percent under TPP-12.[12]

Although there are two TPP economies with which the United States trades more than it does with Japan—Canada and Mexico—the existence of NAFTA means that US gains with these two trading partners under TPP will be of much lesser magnitude than what it would accomplish with Japan, with which the United States has no FTA. All told, the United States already has FTAs with its first-, second-, fourth-, fifth-, seventh-, and ninth-largest trading partners that are negotiating alongside it in the TPP (Canada, Mexico, Australia, Chile, Singapore, and Peru). Japan is notable by its absence from this list.

Like the United States, Japan would benefit from participation in TPP. By joining TPP, it stands to gain $105 billion or 2 percent in income, and $140 billion or 11.2 percent in exports. A considerable share of the income gains would come from the opening up of Japan's domestic economy—reduction of import tariffs and non-tariff barriers protecting the so-called "sacred sectors" of rice, wheat, beef and poultry, dairy, and sugar, as well as liberalization of the services sector and easing restrictions on foreign investment. Increased imports would lead to lower prices for goods and services for Japanese consumers, as well as efficiency and productivity surges for existing and new industrial and service sectors.

Economic partnerships are one element of soft power and send a strong message of shared interests.

For the United States and Japan—but not for them alone—TPP serves broader strategic goals. While economic partnerships cannot replace military alliances as a means to engage with purely security challenges, they are one element of soft power and send a strong message of shared interests. If the first- and fourth-largest economies in the world are able to exhibit the political strength to overcome resistance from domestic special interests in the service of broader national goals, then the completion of such an ambitious negotiation as TPP will reinforce US and Japanese security interests in Asia.

Policy Options and Recommendations

Any considerations about alternative futures for the Pacific Rim economies have to be grounded in the inescapable reality of the overwhelmingly dynamic growth of China and its neighbors in East and Southeast Asia. Although China's economy has slowed recently, sustained annual growth in the 7 percent range recently predicted by Chinese Premier Li Keqiang for 2014 does not seem unreasonable for the next few years. With a 2012 GDP of $8.2 trillion, China's economy alone is nearly as large as all seven Asian countries currently participating in TPP combined ($8.4 trillion) and more than half as large as that of the United States ($15.7 trillion). Though China is not participating in TPP talks, the country's preponderance as a global economic power means that these negotiations as well as any future trade-policy actions are about China as much as the countries directly taking part.

The failure of TPP could lead to disillusionment with free trade as an avenue to economic prosperity.

Building a Framework for Engagement with China

An overriding question the United States and Latin American countries need to ask themselves in considering policy options for the future is how to find common ground for engagement with China. This effort must consider China's model of state capitalism, its desire to be a provider of security in Asia through its contribution to "regional economic cooperation" and "peaceful development," and its unwillingness to adopt high-standard Western economic rules and principles.[13]

In institutional terms, the issue becomes either how to keep TPP and RCEP complementary in their objectives so they can one day lead to a Free Trade Area of the Asia-Pacific, or to bring China and other emerging economies back to the Geneva negotiating table of the WTO on a basis of a multilateral agreement that is acceptable to all sides. But how far should the existing TPP members go to accommodate a rising China? Should China at some point be invited to join TPP? There is certainly a purely economic case to be made for such a step: a TPP with China would provide important income gains over ten years for the United States (1.6 percent), China (4.7 percent), and Japan (4.4 percent).[14]

In this context, Vietnam is a revealing case study and perhaps offers reason for optimism. Although Vietnam shares China's communist history with restricted political liberties and a large role for the state in the operation of the economy, Vietnam has had tense political relations with China. China is Vietnam's largest trading partner and a major investor in Vietnam. Nonetheless, Vietnam has joined TPP not only because of its important commercial ties to the United States, but also as a way to balance Chinese economic dominance in Asia. While challenges remain to bring Vietnam fully into TPP's disciplines, its differing economic model has not been a barrier to negotiating as an equal with the United States and other democratic, market-based economies.

Latin America suggests a potentially different message. The four Pacific Alliance countries—and many others in Latin America—will continue to strengthen their deep commitments to democracy, the rule of law, free trade, and market-driven economies. While these convictions have survived three elections (in Mexico, Chile, and Colombia), the common purpose that originally brought them together was to maximize common commercial opportunities across the Pacific. It is worth asking whether an economic downturn, a closing off of US, Asian, or European markets, or the failure of TPP would lead to the strengthening of political forces opposed to a liberal, outward orientation. The rise of populist movements of the right and left in the European Union should serve notice.

Neither Latin America's institution-rich political landscape nor Asia's more pragmatic, informal way of organizing itself matches the political commitments born of war and the resulting sacrifices of sovereignty that EU countries have made. Opening TPP to more Latin American countries would be one way to anchor the region more firmly in a community of like-minded states devoted to high-standard rules of commerce that are also a major source of prosperity for their citizens. Conversely, the failure of TPP could lead to disillusionment with free trade and international economic engagement as an avenue to prosperity.

The most urgent priority for TPP is to ensure that Japan and the United States resolve their outstanding differences.

Recommendations

Here are nine concrete steps that can be taken to promote the Asia-Pacific trade agenda to ensure the United States and Latin America benefit.

1 **President Barack Obama should publicly champion his international trade agenda and engage with Capitol Hill to explain the merits of an Asia-Pacific trade agreement.** This would help ensure the backing of a strong contingent of Democrats for the Trade Promotion Authority that is a prerequisite to completing a high-ambition TPP. At the other end of Pennsylvania Avenue, the Senate Finance Committee should accelerate the release of its draft TPA bill that is likely to contain reforms that will draw in Democrats without sacrificing bipartisan support. The United States would suffer a major diplomatic setback should the Trans-Pacific Partnership fail.

2 **The US administration must be bolder in its advocacy about the geoeconomic benefits of TPP so the debate is not misrepresented by groups voicing narrow political and economic interests**. TPP (along with the Transatlantic Trade and Investment Partnership and the Trade in Services Agreement) is fundamentally about creating new rules of the road for the global economy that would benefit the United States as well as the many countries in Latin America with open, market-based economies. The administration must make this broader objective known by highlighting the risks to US prosperity and well-being from the rise of a state-dominated economic model—both to policy elites and to a public that is restive and often skeptical of US international engagement.

3 **The most urgent priority for TPP is to ensure that Japan and the United States resolve their outstanding differences over agricultural market access.** To ease that process (and similar challenges in other TPP countries), TPP members should create a common trade adjustment funding mechanism—similar to the EU's European

Globalization Adjustment Fund—for sectors impacted adversely by the deal's removal of tariff or non-tariff barriers. Each TPP member country would contribute from national budgets to the fund, which would be administered by a small secretariat consisting of high-level civil servants from each TPP country.

4 **TPP member countries should prioritize what role, if any, China should play in the talks once Japan's position in the agreement is assured.** Given China's recent saber rattling in Asia, admitting China now could send the wrong message. But as TPP members (and China) would prosper more with China as a member, TPP countries should place China (and other desirable candidates) on a list of countries that will be invited to join the talks as observers and conditionally offered full membership upon conclusion. While there is a risk that China may view even such a flexible approach as presenting it with an unattractive fait accompli, there is a need to avoid a replay of the unsatisfactory conditionality that governed China's accession to the WTO.

5 **With overlapping countries, member states should begin consultations to integrate TPP and RCEP once both agreements are concluded.** Alternatively, the focus of trade liberalization could return to the WTO if enough common ground can be identified. TPP is not an end in itself and raises the longer term challenge of trade policy architecture in Asia-Pacific and globally.

6 **TPP signatories should concurrently explore the potential for an "Atlantic and Pacific Free Trade Agreement" uniting TPP and TTIP with the European Union.** This would mitigate the risk that tackling too many issues will divide TPP and RCEP members and prevent rapid progress on a broader Atlantic and Pacific FTA. As a first step, a mechanism should be found to allow the European Union to have TPP observer status in those areas where there is an overriding need for TPP-TTIP coherence and mutual reinforcement, such as regulatory cooperation.

7 **Colombia, Costa Rica, Panama, and other outward-looking countries with free-market policies in Latin America who wish to join TPP should be welcomed into the talks.** This would create more geographical balance within TPP. As a first step in that process, Costa Rica and Panama should join the Pacific Alliance to strengthen the bloc's negotiating leverage both within TPP and in other trade policy fora.

8 **TPP countries should advocate forcefully to ensure the final agreement leads to measurable rationalization of rules of origin and not just a collection of overlapping bilateral deals.** Doing so would ensure that companies can take greatest advantage of participation in supply and value chains across the Pacific to create more choices and lower prices for consumers. ROOs need to be cumulated in a liberal way that prevents local content rules from vitiating the deep integration opportunities that TPP presents.

9 **The TPP negotiating process should be made more transparent without sacrificing the confidentiality that characterizes all international negotiations, and its goals should be communicated more clearly.** TPP's inclusion of new issues like regulatory cooperation has given rise to a debate about its impact on participating governments' ability to maintain high levels of consumer, health, and environmental protections. The US administration needs to communicate more effectively that TPP, like other recent agreements, is a vehicle for defending high US standards.

Endnotes

1 The TPP was launched by Singapore, Brunei, Chile, and New Zealand in 2004, the United States, Peru, Vietnam, and Australia joined the agreement in 2008, followed by Malaysia in 2010. Mexico and Canada joined in 2012, and Japan in 2013. Taiwan and Korea have both also expressed interest in TPP.

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14 Petri and Plummer, op. cit.

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