B Brief

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TTIP and TPP - A Threat to Latin America?

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For centuries, Latin America's economies have revolved around exporting commodities – be it digging up minerals and hydrocarbons, or planting soya or coffee, the region has historically relied on shipping natural resources overseas.

Depending on the era, this could certainly be a lucrative endeavor, but commodity prices are notoriously fickle, and a dependence on natural resources stunted the region's efforts to build the manufacturing supply chains that have been instrumental in East Asia's rapid industrialization.

In the post-World War II era, many Latin American countries attempted to address this commodity reliance by implementing import-substitution industrialization policies. In practice, this meant imposing high tariffs to discourage imports, thus protecting domestic industry.

But without international competition, Latin American products often turned out over-priced and underwhelming. And when the region *did* try to liberalize in the 1990s, it did not work out so well.

As the 20th century gave way to the 21st, a number of Latin American countries reverted back to commodities, including agricultural products produced using increasingly sophisticated technologies. They also went back to protectionist measures such as local content requirements aimed at supporting a domestic manufacturing sector struggling with currency appreciation.

This was a viable strategy while Chinese demand for raw materials pushed prices through the roof. But those prices have fallen in recent years, and the region now faces a familiar challenge: How to move beyond commodity exports and toward successful integration into international trade networks.

As timing would have it, just as Latin American countries such as the Pacific Pumas (Chile, Colombia, Mexico and Peru) seek deeper integration into global trade, the world debates a series of mega trade deals.

How these deals will affect the region is the subject of a new Bertelsmann Foundation study, *A Chain Reaction? Effects of Mega-Trade Deals on Latin America.*

Let’s start with the Trans-Pacific Partnership, or TTP, an agreement between mostly Asian and American countries including Mexico, Chile and Peru. According to the modeling conducted with the Ifo Institute, Peru could be a big winner here. Our model suggests TPP could lead to a 2.4 percent increase in real income. Specifically, we see a 45 percent value-added boost to the metal sector. These results stem from the theory that once tariffs are lowered, Peruvian producers are more likely to refine commodities domestically and to export more valuable intermediate goods. In other words, instead of just digging it up and shipping it abroad, more steps towards a final product would be conducted in Peru.

For Chile and Mexico, however, TPP may not be such a big deal. Both countries already have deep trade agreements with major TPP partners, so our model suggests a new agreement might only have a marginal impact.

The Trans-Atlantic Trade and Investment Partnership (TTIP), the proposed trade agreement between the United States and the European Union, could pose more of a threat to Latin America. Many Latin American countries trade extensively with the United States. If the U.S. and EU come to an agreement, Latin America could lose its insider access to U.S. markets.

For example, Mexico, which has traded freely with the U.S. since the implementation of NAFTA in 1994, conducts nearly 80 percent of its trade with Uncle Sam. Mexico would still retain certain advantages, such as proximity and cost of labor, but increased U.S. trade with the EU could syphon-off a degree of trade. If the EU gets NAFTA-like access, Mexican exports to the U.S. could fall by over five percent.

What about the countries that are not involved at all?

Mercosur countries on the region’s Atlantic coast are not participants in TPP, TTIP or any of the other mega-deals we analyzed.

The biggest of these countries, Brazil, is not party to any of the mega-deals either, and maintains relatively high tariffs. Our model suggests that in terms of growth, the mega-deals will not have a major effect either way.

But they *will* effect Brazil’s export portfolio. With less relative access to markets participating in the mega-deals (e.g., the U.S., EU and Japan), Brazil could increasingly rely on trade with China—another country not involved in the deals and that does not need Brazil’s manufactured goods. In our model, Brazil’s manufacturing sector would shrink in all scenarios, threatening to leave to country back where it started: digging things out of the earth and sending them abroad.

Dealing with Mega-Deals: Opportunities and Challenges

But all is not lost. The regional mega-deals currently under negotiation do provide an opportunity for countries to enhance their integration in global value chains. This is particularly relevant in Latin America, where cross-border connections have been largely absent due to the long shadow of import-substitution industrialization policies.
In many cases, remaining outside of transnational value chains resulted in loss of competitiveness of domestic industries, which lack access to low-cost inputs and the latest technology. Too often the response has been to increase trade barriers, further separating the domestic market from global integration. Consequently, the cost of being left out increases.

The new mega-deals come at a time when Latin American countries are in crisis—especially the large economies that have avoided integration. Now could be an opportunity to realign with global trade. For better or worse, TPP and TTIP could redefine global trade in the 21st century. At the moment, a Latin American perspective is largely lacking in the negotiation process; in TTIP, it is excluded by definition. But Latin American countries can move unilaterally to ensure that tariffs and regulations match what will become the new global standard.

Of course, alternatively, they could rebuild protective economic walls. But if they do, they just might have to pay for it later on down the road.

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