Global Economics

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Special Report

Tuuli McCully 416.863.2859 tuuli.mccully@scotiabank.com
Neil Shankar 416.866.6781 neil.shankar@scotiabank.com
Neil Tisdall 416.866.6252 neil.tisdall@scotiabank.com

The Trans-Pacific Partnership To Benefit Asia-Pacific And Latin America

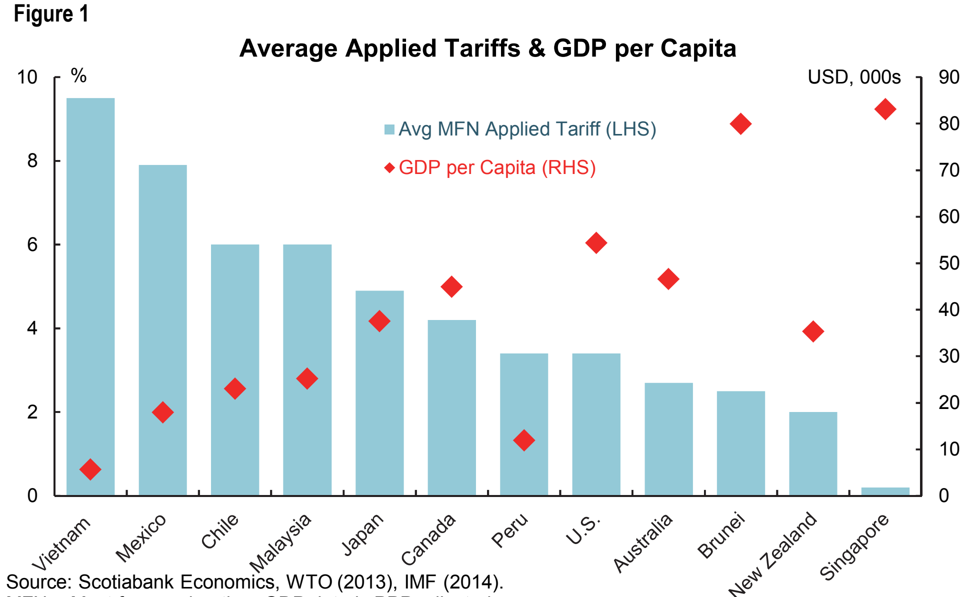
The Trans-Pacific Partnership (TPP) will provide considerable benefits for the 12 member countries by promoting manufacturing and services activity, boosting investment, and helping members reduce their reliance on Chinese demand. For these benefits to be realized, a legal review and ratification of the agreement by each member country is required. While full details of the TPP have yet to be published, this report provides an overview of some of the main benefits of the agreement for member countries in Latin America (pages 2-3) and Asia-Pacific (pages 3-5).

The TPP is the largest trade agreement in history. Participating countries have a total population of more than 800 million and account for roughly 40% of global GDP, a quarter of the world's merchandise trade, and close to 30% of global inbound foreign direct investment (FDI). The TPP is also a "modern" trade agreement. In addition to promoting economic growth through trade and investment liberalization, it would establish a new standard for economic integration and regulatory harmonization. While reducing tariffs as well as non-tariff and technical barriers to trade, the agreement simultaneously aims to streamline frameworks for investment flows and governance, including such areas as e-commerce, intellectual property, dispute settlement, government procurement, labour practices, environmental protection, and the role of state-owned enterprises.

Trade and investment liberalization would not only increase the potential market size for domestic companies but it should also raise productivity and innovation through enhanced access to technology and expertise. Moreover, efficiency gains would result from increased competition as domestic industries are aligned with each country's comparative advantage. Trade liberalization generally benefits the smallest economies most, as well as those that have substantial existing trade barriers. As Figure 1 demonstrates, economic openness and economic development correlate strongly.

Given that manufacturing accounts for around three-quarters of world merchandise trade, trade liberalization and increasing supply chain integration under the TPP would provide the member states' manufacturing sectors with the largest nominal benefits, even though the sector's import penetration is already significant. Meanwhile, the services sector should also benefit substantially, since the TPP focuses on services, which are often among the most protected sectors, and bearing that the agreement includes several rapidly growing developing economies and services tend to increase in importance as a country's income rises.

Figure 1



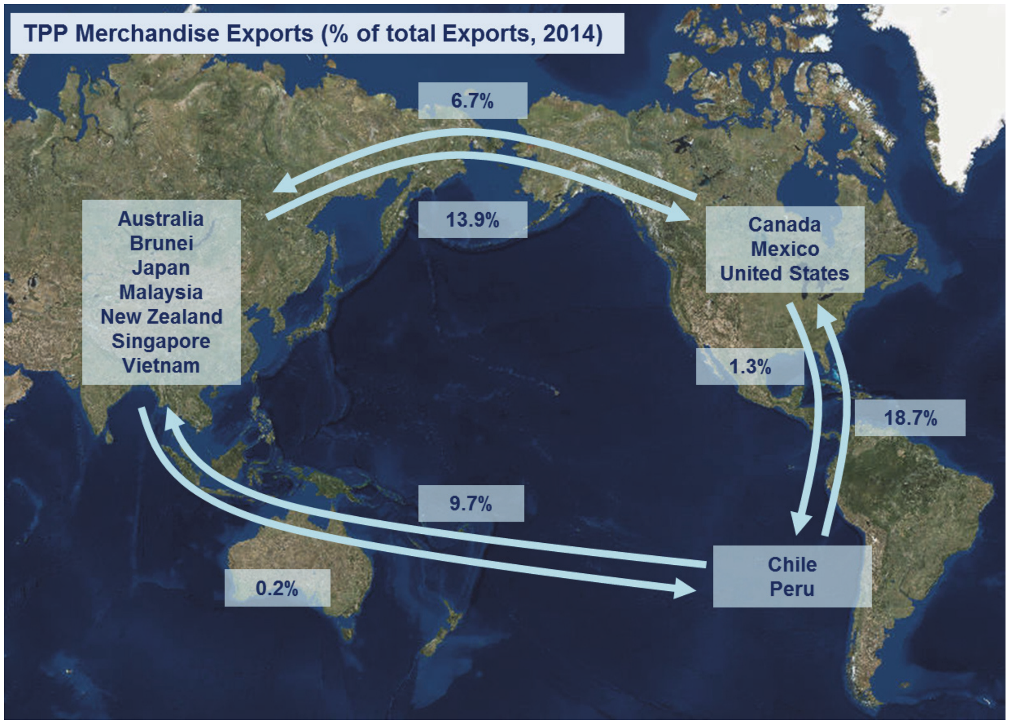
Source: Scotiabank Economics, WTO (2013), IMF (2014).
MFN = Most favoured nation. GDP data is PPP adjusted.

The U.S. market will continue to play a dominant role in TPP trade and investment dynamics (see Figure 2). However, the agreement should encourage larger flows between the Latin American and Asia-Pacific regions. Exports between TPP nations amounted to US$2.1 trillion in 2014 (up 24% since 2010), but the proportion of intra-TPP exports fell from 82% of total exports in 2010 to 48% in 2014. While the relative importance of the Latin American-Southeast Asian trade and investment relationship has waned over the past decade due to expanding trade linkages with China, this agreement serves as an opportunity to reestablish strategic commercial ties.

Chile

Chile is the only TPP member that has existing free-trade agreements (FTAs) with all other participating nations (see Figure 3), limiting the country's exposure to the traditional benefit of greater market access gained from an FTA. However, given the broader scope of the TPP compared with existing agreements, there is an opportunity for Chile to deepen trading relationships with its current partners by reducing non-tariff barriers. Moreover, the agreement serves to boost investment flows with other TPP nations; among the members, Chile has an existing bilateral investment treaty only with Malaysia. Chile is well-positioned to attract investment as it consistently tops the list of Latin American countries in the World Economic Forum's Global Competitiveness Index; the country also enjoys the benefits associated with strong governance when compared with its regional peers, as indicated by Transparency International's Corruption Perceptions Index.

Figure 2



Source: Scotiabank Economics, IMF Direction of Trade Statistics.

Chile enjoys a comparative advantage in mining, supported by well-developed mining infrastructure and a favourable investment climate. Nevertheless, the sector is heavily dependent on shipments to China, which represent about a quarter of total exports. Strengthening ties and further reducing trade barriers with fellow TPP nations would offer Chile an incentive to diversify its raw materials exports and focus on higher value-added mineral processing and sector-related services. The Chilean agricultural sector also stands to benefit from the TPP. For example, the Sanitary and Phytosanitary Measures Chapter of the TPP would potentially streamline agricultural exports to Japan and Canada by standardizing health and safety regulations.

Mexico

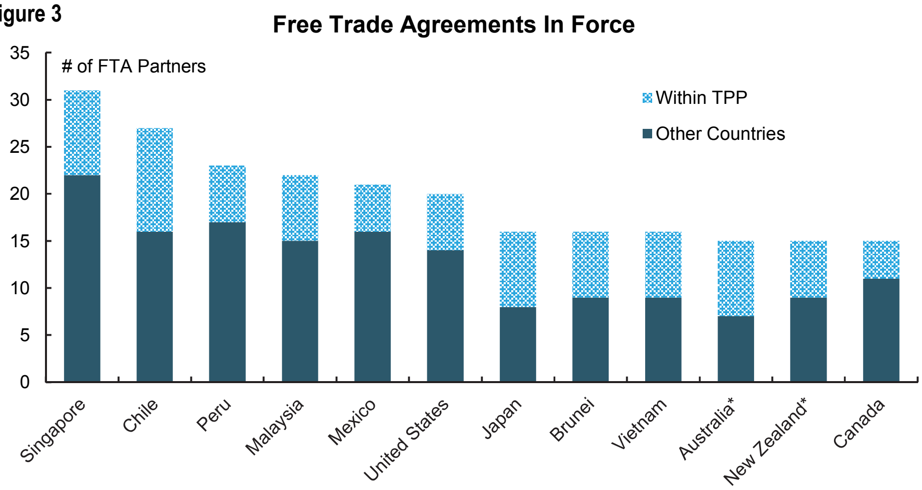
Mexico would be one of the TPP's biggest winners in terms of potential GDP and export growth. Its proximity to the world's largest consumer market has defined its manufacturing and export strategies, concentrating a significant proportion of high value-added factories — primarily automotive and electronics — in the Northern States. Mexican auto parts manufacturers will remain the dominant supplier to the U.S. market even with looser rules of origin stipulated by the TPP, given the established supply chains and proximity between auto assembly plants in the Southern U.S. and factories in Mexico. Japanese car makers would likely increase FDI in Mexico as a result of the TPP, in the form of upgrading and expanding existing factories due to freer capital flows and comparatively inexpensive labour costs. The hourly compensation cost in manufacturing in the U.S. and Canada is around US$36, in Japan around $29, while the equivalent cost in Mexico is less than $7 per hour.

Mexico is the world's largest exporter of flat-screen televisions in the world, with most major electronics manufacturing companies operating factories across the Northern and Central States. The electronics sector also benefits from low labour costs. Mexico would likely strengthen its position as the preferred supplier of TVs to the U.S. market given the low cost of shipping to the U.S. and the high-value-adding processes already established in Mexican factories. As an added bonus, Mexican electronics manufacturers would also increase their market access to the rapidly growing Southeast Asian region and Australia.

Peru

Peru has existing FTAs with most of the large member countries of the TPP and, similar to Chile, the expanded scope of the TPP should benefit the agriculture, fishing, and resource industries underpinned by the reduction of non-tariff barriers, enhanced supply chain integration, and a more favourable investment framework. There would also be the potential for improvement to Peru's market access to the fast-growing economies of Vietnam and Malaysia, as well as deeper integration with Australia, another mining power house. Peru is a global leader in mining (e.g. copper) and extraction, and would therefore benefit from Vietnam's rapidly growing industrial capacity and its ambitions to emerge as a greater manufacturing hub.

Figure 3



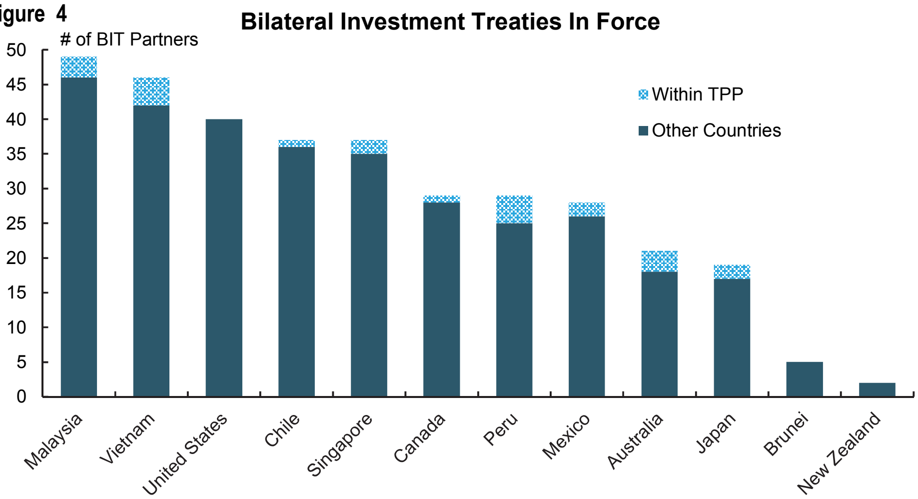
Source: Scotiabank Economics, Asia Regional Integration Center, Organization of American States Foreign Trade Information.
*Excludes South Pacific Regional Trade and Economic Cooperation Agreement.

The percentage of Peru's mineral reserves that are being developed or explored is low compared to its peers, providing ample opportunities for investment through foreign exploration activity. Indeed, Peru is well-positioned to attract investment as it ranks the highest among its Latin American peers in the World Bank's Ease of Doing Business report. Canada is the leader in FDI in Peruvian mineral exploration, having injected nearly $80 billion into the sector as of 2013, while companies from the U.S., Australia and China are also increasing their presence in the Andean nation. As previously inaccessible reserves become available for exploitation alongside improving technology, mining and exploration concessions granted to foreign operators in Peru will become increasingly valuable. Given the anticipated streamlining in legal and environmental regulations under the TPP, members would likely have a competitive advantage over China in the granting of exploration permits and concessions.

Australia

Australia's post-mining investment boom phase accentuates the importance of the TPP agreement as the country looks for growth opportunities in other sectors and attempts to lessen its export dependence on China, which purchases 36% of Australia's total shipments abroad. The TPP is Australia's first free trade agreement with Canada, Mexico, and Peru. Increased market access to these countries would deepen ties with North America and support diversification of the country's external sector. Foreign direct investment into Australia also stands to increase as the country's current number of bilateral investment treaties is relatively low, with only 3 TPP member countries as current partners (Figure 4).

Figure 4



Source: Scotiabank Economics, UNCTAD Investment Policy Hub.

Education and financial services exports are experiencing double digit annual growth and new market access to TPP member countries would increase opportunities for these service providers. Preferential temporary entry arrangements for Australian professionals and the ability to provide investment advice and portfolio management services to a wider range of customers are among some of the benefits service providers would realize under the TPP agreement.

Market access for Australian beef producers would also increase. In 2014, beef exports experienced growth of over 35% y/y and exports will likely continue to increase as tariffs on beef into Mexico and Canada are eliminated within 10 years of entry into force. Beef is Australia's eight largest export, proving important in the country's diversification efforts. There is also a potential for rapid export growth potential in other agricultural products, such as sugar, rice, and dairy.

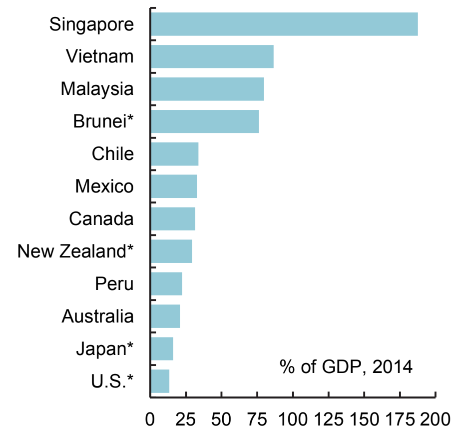
Brunei

Brunei is the smallest of the TPP member nations with a population of less than half a million. However, Brunei is the third largest producer of crude oil in Southeast Asia, making it the fourth richest nation in the world in GDP per capita terms. The global downturn in oil prices has plunged the nation into recession for the past two years, with a likely third year of contraction forthcoming in 2015. Policymakers are eager to attract foreign investment to not only increase deep water oil and gas exploration, but to also expand the financial services industry and diversify the Bruneian economy. Brunei would stand to benefit from enhanced financial integration with TPP member nations to grow its Takaful (Islamic insurance) industry.

Japan

The TPP would likely strengthen Japanese trade dynamics over the coming years; the country's goods and services exports account for only 16% of GDP, the second smallest share among the 12 TPP nations (see Figure 5). Japan does not have an existing trade agreement with the U.S., Canada, or New Zealand. The TPP represents an important element in Prime Minister Shinzo Abe's economic revival plan; the "third arrow" of structural reforms includes the opening of the economy via trade liberalization. While local farmers have expressed concern, Japanese policymakers are hoping that the TPP agreement would underpin the country's agricultural reform process, making the sector more efficient. Similarly, productivity gains should result from increased investment flows (e.g. due to knowledge spillovers); Japan has been relatively slow in negotiating investment treaties having a bilateral agreement in place only with Vietnam and Peru among the TPP nations (see Figure 4).

Figure 5 **Exports of Goods & Services**



* 2013 data. Source: World Bank.

The Japanese automotive industry, in particular, would benefit from preferential access to the U.S. market as the country is the biggest buyer of Japanese cars. Nevertheless, the 2.5% U.S. import duty on cars and 25% on trucks which would be phased out over 25 and 30 years, respectively, make the benefits to the auto sector challenging to assess. Meanwhile, the levy on many auto parts would be eliminated immediately. TPP manufacturers would further benefit from regional supply chain integration that results from the rules of origin requirements for vehicles and auto parts set at 40-45%.

Malaysia

The TPP would grant Malaysia enhanced access to the U.S., Canadian, Mexican, and Peruvian markets; the country did not have a prior free trade agreement in place with these four economies. The first one is particularly important as free-trade negotiations between Malaysia and the U.S. failed in early 2009 after three years of negotiating; the dialogue has since continued under the TPP framework. The TPP would allow Malaysia to diversify its export market; the nation is vulnerable to the ongoing economic growth slowdown in China, which is the largest buyer of Malaysian goods. The Malaysian economy is highly export oriented with exports of goods and services accounting for 80% of GDP (see Figure 5); its key goods exports are electronics, palm oil, petroleum & liquefied natural gas, wood products, and rubber, which would enjoy the benefits of improved market access. As a country with an English speaking population and a relatively educated workforce, Malaysia has potential to increase its share of services trade, which is currently equivalent to around one-fifth of merchandise trade.

Malaysia aspires to attract more FDI into the country once the TPP is in place. Currently, Japan and Singapore are among the main sources of investment into Malaysia, and the agreement would allow for an increased share of U.S. originated FDI. While Malaysia has the largest number of existing bilateral investment treaties in place relative to other TPP members, it does not have such an agreement with the U.S. or most TPP countries. The Malaysian government promotes investment into the manufacturing and services sectors and is aiming to strengthen the country's position as a regional hub for higher value-added manufacturing. Deeper integration into the world's supply chains through trade pacts, such as the TPP, forms an important part of the administration's plan to become a high-income economy by 2020.

New Zealand

The agricultural sector continues to dominate New Zealand's exports. Dairy products are the country's largest export, making up over a fifth of total exports. Under the TPP, dairy exporters would have preferential access to the U.S., Japan, Canada, and Mexico, thanks to higher import quotas and tariff elimination on a number of products. Tariffs on beef exports to Japan would be reduced from 38.5% to 9%, while other key agricultural products would be shipped to TPP member countries tariff free.

Removals of non-tariff barriers are also significant for New Zealand's agricultural sector. Agricultural export subsidies within the TPP region would be eliminated and member countries would ensure that food safety measures do not create unjustified obstacles to trade. The TPP agreement would also open the door to foreign direct investment, given that the country has no existing bilateral investment treaties with any TPP members. The TPP is also New Zealand's first free trade agreement with the United States, Japan, Canada, Mexico, and Peru.

Singapore

Singapore is the most externally oriented economy among the twelve member countries, with exports of goods and services accounting for over 185% of GDP (see Figure 5). Singapore's already-low tariffs and limited non-tariff barriers are highlighted in the 2015-16 World Economic Forum's Global Competitiveness Report as amongst the best in the world. These external sector characteristics have shaped the country into a regional hub for import/export business. Re-exports (foreign goods exported in the same state as previously imported) account for about half of total merchandise exports. Increased market access under the TPP would further the country's openness and deepen ties with North America by establishing Singapore's first preferential trade agreement with Canada and Mexico.

While services account for over 70% of the economy's make-up, services only equate to a quarter of total exports. Singapore's external sector stands to benefit under the TPP, with one-third of total services exports destined for TPP member countries. New rules surrounding e-commerce will ensure government regulations do not unnecessarily impede cross-border data flows and permit the imposition of import duties on electronically transmitted products. Currently, financial and business services account for 13% and 24% of total services exports, respectively. Given that Singapore ranks number one in the World Bank's Ease of Doing Business report, the country is well positioned to benefit from increased investment flows and deeper regional integration within the TPP, which will support Singapore's development as a regional financial and business center.

Vietnam

The TPP would have a significant impact on Vietnam's export-oriented economy; among the 12 nations, Vietnam is the second most export-dependent economy (after Singapore) with its exports of goods and services equivalent to close to 90% of GDP (see Figure 5). Vietnam has emerged as an attractive low-cost manufacturing base in Asia-Pacific, with multinationals shifting production facilities from China to Vietnam. Indeed, Vietnam's labour costs are roughly half of those in China. The TPP would likely boost investment into Vietnam; the country has an existing bilateral investment treaty with only 4 of the TPP nations: Japan, Malaysia, Singapore, and Chile.

Vietnam's biggest export industry is textiles and footwear and it would be a major beneficiary of the TPP, as most tariffs on textiles and apparel would be eliminated immediately. The agreement would encourage the development of regional supply chains and investment concentration as it specifies rules of origin that require use of yarns and fabrics from the TPP region. Accordingly, Vietnam would likely face increased inflows of FDI in the garment and textile industry, with positive ripple effects on employment and technological progress. Another beneficiary would be Vietnam's seafood industry (accounting for around 5% of the country's total exports), which would benefit from the elimination of import tariffs.

Vietnam does not have an existing FTA in place with the U.S., Canada, Mexico or Peru. Regardless, the U.S. has been its major export destination; it purchases around 20% of Vietnam's shipments abroad, a share likely to increase over the coming years. China is the only country whose net garment exports to the U.S. exceed those of Vietnam.

As Vietnam is the least developed economy among the TPP countries (the United Nations' Human Development Index places Vietnam in the 121st place out of 187 countries), the agreement would promote the country's economic development efforts. The TPP provides the nation with an external impetus for implementing (at times challenging) structural reforms and standards regarding such areas as labour rights, environment, state-owned enterprises, regulatory requirements, transparency and anti-corruption, thereby enhancing the well-being of Vietnamese citizens in the long-run.

Scotiabank Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: 416.866.6253 Fax: 416.866.2829
Email: scotia.economics@scotiabank.com