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Policy Brief

TOWARDS A NEW TRANS-AMERICAN PARTNERSHIP

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The global trade regime is undergoing fundamental changes. While World Trade Organization (WTO) member countries continue to work towards an ever elusive agreement, regional initiatives—most notably mega-regional agreements—have emerged as the focal point of countries' efforts to advance a trade agenda that responds to the realities of 21st-century commerce. These mega-regional deals have the potential to reshape the global trade landscape, bringing about important changes both in the geography of integration as well as in its scope and depth. As this new architecture emerges, the Western Hemisphere finds itself without a coherent vision to promote its own integration. This needs to change if the region is to make the most of its trade relations in a challenging global environment.

While naysayers may contend that intractable political differences stand in the way of region-wide initiatives, we believe the emergence of new drivers of trade integration beyond tariffs and other traditional market-access issues presents actionable strategic options to integrate the Americas. We argue for a region-wide integration initiative based on two pillars: (1) promoting convergence of existing free trade agreements (FTAs), and (2) implementing an ambitious hemispheric-wide trade facilitation agenda. Critically, these policies would address two prominent obstacles to trade in the region while removing the need to embark on the challenging road of new region-wide FTA negotiations. We see in this proposal a timely convergence between what is politically feasible and what is economically necessary to kick-start integration in the region. The time is ripe for a leap forward: a Trans-American Partnership (TAP), an initiative tailored to the Americas' particular challenges and diverse policy frameworks that would deepen integration in the Americas in a pragmatic yet powerful way.

I. New emerging dynamics in the global trading system

We begin this essay by recognizing some new drivers of trade integration at the global level. The existing network of FTAs is relatively comprehensive and has successfully dismantled traditional barriers such as high tariffs and import quotas. Therefore, any additional agreements that address these issues are subject to diminishing returns. As a result, countries are looking to alternative policy mechanisms to more effectively deepen economic integration. These strategies include addressing some prominent remaining gaps in the universe of traditional FTAs, enhancing the scope of traditional agreements to incorporate the so-called beyond-the-border regulatory issues, improving the efficiency of the existing network of FTAs through harmonization and convergence of overlapping rules, and addressing operational bottlenecks facing firms through trade facilitation initiatives. We will now review each of these new key drivers.

First, there remain significant "missing links" in the current global trade architecture, as major trading partners still lack bilateral FTAs. These gaps exist among developed nations (e.g., the US, EU, and Japan[3]), large developing countries (e.g., Mexico, Brazil, China, and India), and between developed and developing countries (e.g., the US and Japan with China). Second, due to the growing importance of

[3] The US–Japan gap will be closed by the TPP when ratified, as will the US–EU gap when the TTIP is completed.

regional and global value chains, trade deals are increasingly going beyond market access to include beyond-the-border issues such as regulatory barriers to trade, services, investment, and intellectual property, among others. Both of these strategies would require formal trade negotiations, which inevitably pose thorny political economy problems.

However, this is not necessarily the case for two additional drivers of global commerce: convergence of trade agreements and trade facilitation measures. First, the current trade architecture built over the last two decades has resulted in multiple overlapping FTAs, each with its own set of rules. Harmonizing certain elements of these agreements—especially those that concern rules of origin (RoO)—would reduce transaction costs and increase firms' options for sourcing inputs, allowing countries to take full advantage of lower tariffs and amplifying the economic impact of trade agreements. This is the essence of FTA convergence. Second, trade facilitation measures that address the logistical costs incurred by exporters and importers are becoming critical features of modern trade policy. Trade facilitation refers mostly to "soft" infrastructure (policies and regulations), though it can be extended to "hard" infrastructure as well (e.g., roads, ports, and airports). Some good examples of soft trade infrastructure policies—our focus in this paper—are the harmonization and standardization of procedures for moving goods through customs, the implementation and interoperability of single windows for foreign trade, the use of authorized economic operator programs, and coordinated border management initiatives.[4] These last two drivers, convergence and trade facilitation, are much less politically charged than traditional trade negotiations and thus can be implemented more easily.

The mega-trade agreements under negotiation today clearly underscore the importance of these new drivers. The Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP)—as well as the often overlooked Pacific Alliance (PA) in Latin America and the Caribbean (LAC) and the Regional Comprehensive Economic Partnership (RCEP) in Asia—hold the potential to fill major missing FTA links between the United States and Japan and between the United States and the European Union, respectively. At the same time, a large number of countries in the TPP (as well as in the PA and RCEP) already have FTAs in place with each other, meaning that, once implemented, the TPP will promote convergence by harmonizing existing rules and concessions negotiated in prior agreements. Finally, these new regional initiatives place particular emphasis on enhancing connectivity through a variety of trade facilitation procedures, in many cases going well beyond what has been achieved at the multilateral level.

[4] Single windows allow traders to electronically submit all documentation related to the regulatory and administrative requirements of relevant government agencies through one single facility and thus also facilitate information-sharing among countries' customs agencies; authorized economic operators allow customs agencies to pre-certify firms as complying with World Customs Organization security standards, thereby allowing for simplified customs procedures; finally, coordinated border management refers to a broad range of measures to enhance interoperability among government agencies at border crossings. These are but examples of a wide array of trade facilitation measures that can be implemented at the national, regional, or multilateral level.

Countries throughout Latin America are also taking advantage of these new dynamics in the global trade architecture. The Pacific Alliance—a recent sub-regional initiative between Chile, Colombia, Mexico, and Peru—is a good example of how to promote convergence of existing FTAs. The four members already had FTAs in place with each other that included tariff concessions covering most of their bilateral trade flows. However, the existence of different rules of origin limited firms' ability to source inputs from other Pacific Alliance countries and still qualify for preferential tariffs. To address this issue, the Pacific Alliance bloc negotiated a new RoO regime that allows for accumulation among all members. They are now focusing their efforts on trade facilitation measures, such as the interoperability of national single-window systems and mutual recognition agreements for authorized economic operator (AEO) programs in order to streamline export and import procedures, among others. Furthermore, the Pacific Alliance and Mercosur have shown political interest in exploring ways to advance integration between the two blocks. If successful, this move will help bring Brazil and Mexico—the region's two economic giants—closer together and put recent trade disputes behind them. Similar efforts are also being prioritized in Central America and the Caribbean. These and other initiatives show that governments across LAC have already embraced pragmatic policies to enhance connectivity and make the most of their existing trade agreements. However, what is lacking is a regional framework that builds on this momentum and channels these initiatives into a coherent integration strategy for the Americas. Such a strategy is necessary if LAC countries are to make the most of the opportunities for integration the current scenario presents.

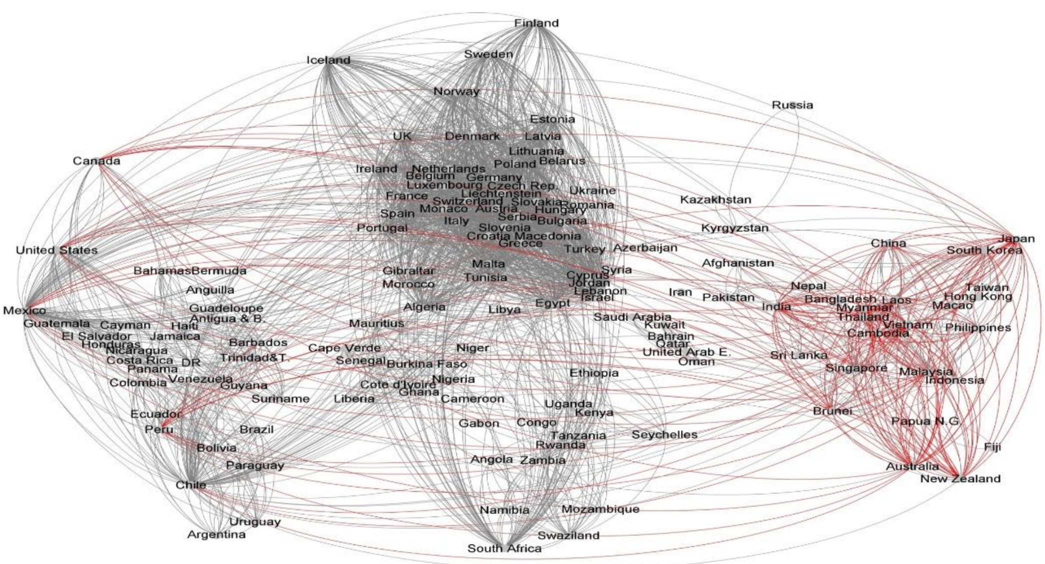
II. Trade architecture in the Americas: Time for a new Trans-American Partnership[5]

The current trade architecture in the Americas is the product of multiple waves of regional integration starting in the 1960–70s and continuing through the so-called new regionalism of the 1990s and 2000s, which created a complex web of agreements within the region and with extra-regional partners (see Figure 1 and Table 1). While this network of FTAs has generated myriad benefits for the region, it has also resulted in overlapping agreements among subsets of trade partners and unevenness in the coverage of agreements across the region—both of which hinder trade. As a result, the current trade architecture is characterized by two loosely defined groups of countries. The first group more enthusiastically embraced the FTA model during the 1990s and 2000s and is consequently closely linked together and to and the North American market through a series of overlapping agreements (henceforth known as FTA-linked countries). These agreements, often called new generation FTAs, feature a high degree of liberalization and comprehensive rules on beyond-the-border issues. The second group prioritized different integration goals and has consequently developed a less dense network of more limited trade agreements. To be precise, the first group of FTA-linked countries includes partners to the

[5] The original idea on a new Trans-American Partnership (TAP) was put forth by Talvi (2014).

North American Free Trade Agreement (NAFTA), the Central America Free Trade Agreement (DR-CAFTA), and the Pacific Alliance—that is, the United States, Canada, Mexico, Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, Panama, Dominican Republic, Colombia, Peru, and Chile. The second group includes the remaining countries of the Americas. However, some of the proposals included in this paper—in particular, RoO convergence—could be extended to a larger number of countries linked by more shallow bilateral trade agreements (although this would entail more complex technical and sequential issues for implementation). This extension would be especially relevant for those agreements between Mercosur and the Pacific Alliance countries.

Figure 1. Worldwide FTA Network



Source: IDB INTRADE-Database / RTA-Exchange.
Notes: Lines in black represent FTAs implemented; lines in red represent FTAs under negotiation (estimated implementation 2017).

This current trade regime presents two key challenges for the region: (1) the high costs associated with overlapping FTAs *within* the first, densely linked group, and (2) the lack of connectivity *between* this group and the second group. Policymakers throughout the region are well aware of these challenges and are currently working to overcome some of these barriers, as mentioned above. Yet these initiatives, however promising and welcome, fall far short of a comprehensive strategy to eliminate the obstacles implicit in the region's current trade architecture. In addition, they remain largely decentralized and disaggregated across sub-regions and issue areas, and as a result opportunities to exploit economies of scale and scope are squandered. Recognizing that this hemisphere offers opportunities for greater connectivity, the natural next step is to engage countries in a Trans-American Partnership (TAP), an initiative that can channel the current drivers of integration in the region while taking into account political economy constraints. The proposed TAP would be grounded on two key drivers: (a) convergence of existing FTAs, and (b) trade facilitation to better connect all countries in the Americas regardless of their FTA status. To be clear, this is not a proposal to engage the region in a new phase of full-fledged trade agreements aimed at connecting "missing links" or expanding the agenda to beyond-the-border issues. Instead, it should be seen as a necessary first step towards deeper integration that would maximize the economic gains of the existing, hard-won trade architecture.[6]

Table. 1 Canada and the United States' Free Trade Agreements with Latin America and the Caribbean

	FTA Partner	Agreement	Year
CANADA	Mexico, United States	NAFTA	1994
	Chile	Canada-Chile FTA	1997
	Costa Rica	Canada-Costa Rica FTA	2002
	Peru	Canada-Peru FTA	2009
	Colombia	Canada-Colombia FTA	2011
	Panama	Canada-Panama FTA	2013
	Honduras	Canada-Honduras FTA	2014
	Chile, Mexico, Peru, United States*	Trans-Pacific Partnership	2016
UNITED STATES	Canada, Mexico	NAFTA	1994
	Chile	US-Chile FTA	2004
	Guatemala	DR-CAFTA	2006
	Honduras	DR-CAFTA	2006
	Nicaragua	DR-CAFTA	2006
	El Salvador	DR-CAFTA	2006
	Dominican Republic	DR-CAFTA	2007
	Peru	US-Peru Trade Promotion Agreement	2009
	Costa Rica	DR-CAFTA	2009
	Panama	US-Panama Trade Promotion Agreement	2012
	Colombia	US-Colombia FTA	2012
	Canada, Chile, Mexico, Peru	Trans-Pacific Partnership	2016

Note: we only list LAC TPP members here. The TPP is pending ratification.

FTA convergence

The first policy tier involves promoting the convergence of trade rules among FTA-linked countries, i.e., those countries that already have new generation FTAs with each other. While regulatory convergence

[6] A proposal linking LAC countries with the European Union with similar objectives, although requiring traditional trade negotiations, has been proposed recently by Lagos (2014).

encompasses a number of issues, the priority should be to achieve harmonization and cumulation of RoOs. To see why, it is important to look more closely at rules of origin and their role in trade agreements.

The premise of an FTA is to lower (or eliminate) tariffs on goods that *originate* in countries that are parties to the agreement. All FTAs therefore include explicit and precise criteria that define which goods can be considered products of a member country and are thus eligible for preferences.[7] While necessary, these RoOs also impose hefty costs on firms. First, RoOs limit a firm's options in sourcing inputs and material from abroad, thereby undermining the creation of regional and global value chains. Secondly, RoOs generate significant administrative and compliance costs. These are not mere rounding errors: Studies have found that RoO compliance costs can amount to as much as 10 percent of total costs for some products.[8]

When a country is a party to multiple agreements with different RoO regimes, the complexity and administrative burden of compliance—and its associated cost—increases exponentially. In addition, multiple RoOs create barriers to trade even among groups of countries that have bilateral FTAs between each country pair by limiting the use of inputs from any given third country. This is precisely what is occurring today among FTA-linked countries, where the existence of multiple and overlapping RoO impedes the development of robust supply chains, as companies are deterred from setting up production in a given country despite the existence of a bilateral FTA due to RoO requirements. The goal of the TAP is therefore to replace the patchwork of RoOs among these countries with a single RoO regime with full cumulation—that is, one that allows firms in any country to use materials from any of the other countries without jeopardizing preferential access.[9] A single coherent RoO regime for these countries would remove a major barrier to intraregional trade and the emergence of supply chains, allowing the region to reap far greater gains from its existing FTAs.

Trade facilitation

The second policy tier involves ambitious trade facilitation measures to increase trade connectivity in the hemisphere, in particular between FTA-linked and non-FTA-linked countries. Trade facilitation encompasses a wide array of programs and policies designed to address the numerous logistical bottlenecks that create avoidable transaction costs and impede the flow of goods. For the purposes of the TAP, a subset of trade facilitation initiatives that aim to streamline, modernize, and connect countries'

[7] Rules of origin in FTAs take two basic forms. The most common is to specify certain material inputs that must be originating in order for a product to qualify for preferences. This ensures that production processes all take place in the FTA countries, starting with these inputs and continuing up to the final good. An alternative, complementary form of RoO, is to require that a certain percentage of the value of a product originate in the FTA countries.

[8] Estevadeordal and Suominen (2009).

[9] The goal of establishing a single RoO regime with full cumulation in the tier for FTA-linked countries is facilitated by the fact that the rules in the existing agreements between these countries already share many common features. See Estevadeordal and Suominen (2009).

customs operations—often the source of lengthy delays for LAC firms—holds the greatest potential. Such soft infrastructure interventions should include expanding and connecting national single windows for foreign trade, authorized economic operator programs, and other coordinated border management initiatives—measures that are already in place in over a dozen LAC countries.

The TAP would build on this work, improving existing policies and procedures and encouraging coordination among national authorities to enhance their impact on regional trade. For example, cooperation can allow for interoperability of single-window systems, which enables customs authorities to exchange and process information quickly by linking—both technologically and administratively—these systems within the region. Similarly, countries with authorized economic operator programs have the potential to mutually recognize companies' certified status, expanding the opportunities and benefits for participating firms. Such efforts are already underway at the sub-regional level; for instance, the Pacific Alliance is implementing an interoperability program to link the single-window systems of its four members and is exploring mutual recognition agreements for their respective AEO programs. At the same time, Central America is moving towards an ambitious coordinated border management program to integrate the sub-regions' customs systems.

While trade facilitation may not make for splashy headlines, it is of vital importance in the current trade environment. Lengthy delays in moving goods between countries generate high costs in the region and undermine firms' competitiveness in a global economy that demands consistent, just-in-time delivery. A large body of recent empirical work has estimated the positive payoffs of trade facilitation measures that address such delays. For example, an Organization for Economic Co-operation and Development (OECD) report found that streamlining trade procedures has the potential to reduce transaction costs by 5.4 percent;[10] similarly, a 1 percent improvement in trading partners' export and import procedures—as measured by the Enabling Trade Index, a World Economic Forum index that captures various dimensions of hard and soft trade facilitation policies—can boost bilateral trade by 4 percent.[11] Evidence from the region also supports these findings. In a forthcoming study, the Inter-American Development Bank found that exports in Uruguay would increase by around 6 percent if all shipments subject to physical inspection cleared customs within one day.[12] Recognizing how handsome the rewards can be, the TAP would make trade facilitation a priority.

A crucial feature of trade facilitation is its potential to increase connectivity between economies regardless of tariff rates or the existence (or lack thereof) of an FTA. It thus provides the best and most strategic option for forging closer connectivity between FTA-linked and non-FTA linked countries, thereby encouraging a region-wide integration process. In fact, we are already witnessing the emergence of some

[10] Moise, Orliac, and Minor (2011).
[11] Lawrence, Hanouz, and Doherty (2012) and Hanouz, Geiger, and Doherty (2014).
[12] Volpe (2016, forthcoming).

measure of political will to increase connectivity in countries without a history of integration agreements. The Pacific Alliance and Mercosur are currently considering ways to promote convergence between the two blocs. Customs cooperation, interoperability of national single-window systems, mutual recognition of authorized economic operator programs, and other advances in soft infrastructure policies can show the way forward. In the same vein, the United States signed a memorandum of intent covering trade facilitation issues with Brazil in 2015 and more recently with Argentina, during the visit of President Obama in March 2016. Trade facilitation has proven to be a potent tool to deepen integration while removing the need for lengthy formal trade negotiations.

The attractiveness of the TAP lies in its relatively low cost, its timeliness, and its ability to strengthen the *existing* trade network by targeting two critical gaps in the current integration architecture. Rather than starting from scratch, the TAP would build on the hard work of governments in the region over the past few decades. Any further liberalization requiring additional negotiation would be minor. What's more, unlike its alternatives, the TAP is not contingent on the conclusion of existing negotiations. Some observers argue that the best strategy for LAC countries is to latch onto existing mega-regional agreements such as the TPP. However, this stance implies that countries would have to wait for negotiations to be concluded and agreements to be ratified, and would therefore be shut out of their benefits for the foreseeable future. Finally, the TAP would provide a mechanism to expand and enhance intra-regional supply chains, creating opportunities for far more extensive regional linkages than would be the case if only a handful of additional LAC countries joined the TPP.

III. Final words: Learning from the past, leveraging the present, and looking towards the future

The countries of the Americas have made tremendous strides in opening their markets and integrating into the global economy. Much of this progress has come through FTAs with intra-regional partners, and as a result new drivers of integration mirroring broader global trends have emerged in the region. In response, governments across the Americas—despite having diverse economic and political profiles—have begun to pursue policies that address the key remaining barriers to integration through convergence and trade facilitation measures. Most importantly, the private sector is becoming a critical player in this agenda by employing innovative mechanisms to coordinate action at the regional level.[13]

If countries are already moving ahead on this important agenda, why do we need a region-wide partnership? What is the value added of the TAP over and above the existing unilateral and sub-regional

[13] In this context, it is worth mentioning the role of the *Business Council of the Pacific Alliance*, launched with the Pacific Alliance, and the *Americas Business Dialogue*, a hemisphere-wide private sector platform that complements other existing bilateral business dialogues on trade issues launched in 2015 at the Summit of the Americas in Panama. See IDB-ABD (2015).

initiatives? Skeptics might worry that trying to forge broader regional agreements may be counterproductive, distracting from the fast progress of like-minded sub-groups such as the Pacific Alliance. We firmly disagree. At a basic level, the TAP would provide a platform to scale up and coordinate existing sub-regional efforts by bringing in new partners and ensuring that various policies have the greatest possible impact on the whole region. These advantages are especially salient in the trade facilitation area, where there exists enormous potential for connecting different projects underway throughout the region. In terms of convergence of overlapping FTAs, we have shown that the rules of origin in existing agreements already share key commonalities that make constructing a unified RoO regime among FTA-linked countries a perfectly attainable goal. In short, we believe that any transaction costs arising from new RoO negotiations pale in comparison to the impact that a unified set of rules would have on intraregional trade and supply chains.

On a more strategic-political level, it is important to forge links among all countries in the region in order to ensure that the budding sub-regional projects do not lock these groups into separate systems at the expense of a more functional regional architecture. A coherent regional strategy that explicitly works both to deepen integration among FTA-linked countries and to maximize connectivity with non-FTA-linked countries is the best way to channel the momentum of diverse sub-regional initiatives towards common regional goals. This shared agenda is not ideological, but rather very pragmatic, in that it leverages the important progress of the past twenty years into a more coherent system that promotes the development of modern, sophisticated regional value chains, while lowering the costs and uncertainties associated with trade. Many of the countries of the region are individually small, but as parts of a larger and more integrated hemispheric economy they can attract investment and participate in globalized supply chains, reaping the benefits from the success of the hemisphere as a whole.

As this proposal involves linking North American and LAC economies, it will naturally conjure up memories of the failed Free Trade Area of the Americas (FTAA). Pessimists may therefore *prima facie* consider the TAP similarly problematic. Such pessimism, however, would be misguided. The TAP represents a much more pragmatic approach to increasing trade and investment in the Americas; it is a feasible initiative attuned to the region's political realities and economic needs and to a new emerging global environment of large-scale, continent-wide trade pacts. The FTAA failed at least partly because it attempted to foist a single vision of integration—one with strong ideological undertones—onto an economically, politically, and socially diverse region. By contrast, the TAP project can succeed precisely because it acknowledges the diversity within the Americas and identifies pragmatic yet critically important policies tailored to the specific integration challenges facing the region. If adopted, the partnership will become a stepping-stone to deeper forms of integration in the future. It would comprise 981 million consumers and have a combined GDP of more than $25 trillion (37 percent larger than the EU and more than double that of China). Rather than being a quixotic attempt to forge a shared regional vision, the

TAP is a realistic “business plan” for trade in the Americas—one that addresses the most important barriers to regional integration and one that can yield considerable economic gains.

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