October 07, 2015

Economics Group

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Special Commentary

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Erik Nelson, Economic Analyst
erik.f.nelson@wellsfargo.com • (704) 410-3267

TPP Agreement: More Than Initially Meets the Eye

Executive Summary

The Trans-Pacific Partnership (TPP) would essentially eliminate barriers to trade and investment among the United States and 11 other countries. However, the United States already has free trade agreements (FTAs) in place with six of the other 11 TPP signatories, so it is questionable how much further American trade with these countries will be enhanced by the TPP.

The TPP should really be viewed through a wider lens. The charter members account for one-third of global GDP and one-quarter of global trade. Unfettered access to these markets is attractive to economies that currently are not members, and more countries will likely be induced to join as the ranks of TPP members rises. The TPP may even encourage negotiators to reach agreement on a FTA between the United States and the European Union (EU).

Then there is the geopolitical angle to consider. China, which many analysts consider to be the primary challenger to America's geopolitical dominance, is not a signatory country and will likely be excluded from the TPP for the foreseeable future. The TPP may be America's answer to the rising economic and financial power of China.

How Much Will the TPP Really Benefit U.S. Exports?

On October 5, negotiators from 12 nations put the finishing touches on the biggest trade pact in history. If the TPP is ultimately ratified by the governments of the 12 countries, it would essentially eliminate tariffs on trade in goods and services among the member states. It would also enhance investment opportunities among the members. Proponents of the TPP also applaud the provision of labor and environmental standards that are contained in the framework. Because we are not experts on labor and environmental regulations, we will focus in this report on the trade liberalizing effects of the accord.

The United States already has FTAs in place with six TPP members.

The charter members of the TPP include Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. It is well known that the United States has had a free trade agreement in place with Canada and Mexico (i.e., the North American Free Trade Agreement) for the past 20 years. Canada is America's most important trading partner in terms of two-way trade and Mexico claims the #3 spot.[1] Among the other signatories of the TPP, the United States also has FTAs in place with Australia, Chile, Peru and Singapore. If trade is essentially tariff-free already (or soon to be) between the United States and these other six TPP charter members, how much more benefit can the United States expect to receive in terms of trade liberalization?

Indeed, Figure 1 shows that nearly 40 percent of American exports are destined for the six countries that are TPP signatories and with which the United States has existing FTAs already in place. Only 6 percent of American exports go to Brunei, Japan, Malaysia, New Zealand and Vietnam, the other five TPP charter members with which the United States does not have existing

[1] Two-way trade between the United States and Canada totaled $660 billion in 2014. At $534 billion, two-way trade between the United States and Mexico ranked behind China ($590 billion).

FTAs in place. Although tariff reduction could clearly boost American exports to these countries, it is questionable how much effect it would have on overall U.S. exports given the small size of most of these economies. Among these five countries, only Japan is a large economy and a major trading partner of the United States (Figure 2). Malaysia, Vietnam, New Zealand and Brunei each account for less than 1 percent of U.S. exports. American exports to these small economies could double in the years after the TPP is implemented, but it would not make much difference in terms of aggregate U.S. exports.

Figure 1

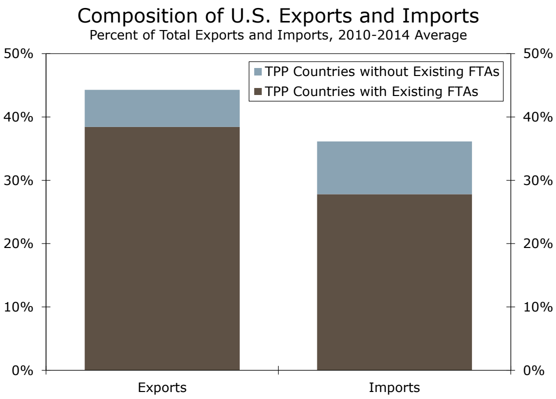


Figure 2

Source: International Monetary Fund and Wells Fargo Securities, LLC

Viewing TPP Through a Geopolitical Lens

The 12 TPP countries account for one-third of the global economy.

Focusing solely on American exports to other TPP signatories may not be the correct way to look at the overall agreement, however. Together, the 12 TPP charter members account for one-quarter of global trade and one-tenth of the world's population. (Figure 3). These 12 countries also represent one-third of global GDP. Joining this free trade area could be enormously attractive to countries that currently are not members.

Indeed, Colombia, Indonesia, the Philippines, South Korea and Thailand have expressed interest in joining the TPP and negotiations between these five countries and the original TPP signatories are already underway. With a GDP of $1.4 trillion in 2014, South Korea is the 13th largest economy in the world. Indonesia's economy is smaller than Korea's, but the country has enormous potential with a population of 250 million individuals, making it the fourth most populous country in the world. If these five countries eventually sign on, TPP countries would then account for one-third of global trade and about one-fifth of the world population. This expanded TPP would be a trade bloc with significant weight in the global economy that would be even more attractive to even more countries.

The TPP could push the TTIP over the finish line.

The TPP with either 12 or 17 members may potentially be such an important trading bloc that it may encourage negotiators to come to agreement on the proposed Transatlantic Trade and Investment Partnership (TTIP), which would be a free trade agreement between the EU and the United States. The EU represents about one-quarter of global GDP and 7 percent of the world's population (Figure 4). Moreover, the EU accounts for nearly 20 percent of American exports and about 60 percent of American capital directly invested abroad. Although barriers to trade and investment between the United States and the EU are already rather low, proponents of the TTIP claim that complete liberalization of trade and investment would be significantly beneficial for both the U.S. and EU economies. Although TTIP negotiations have been ongoing for the past few years, the signing of the TPP agreement may be the catalyst that finally pushes the TTIP over the goal line. The TTIP could further cement the economic integration of the United States and the EU.

Figure 3

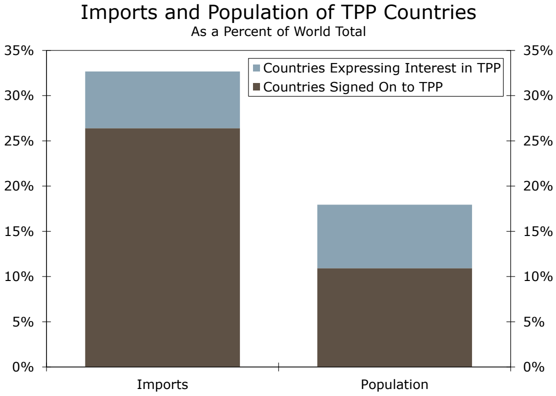
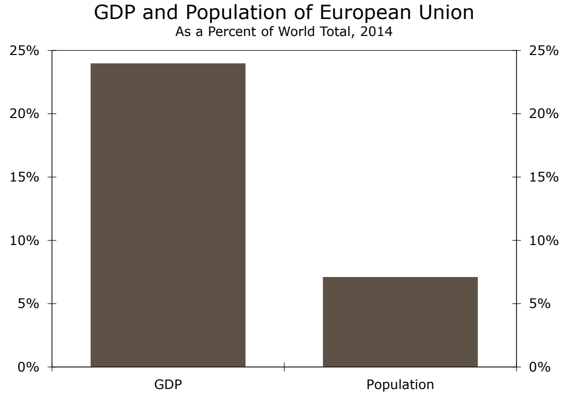


Figure 4



Source: International Monetary Fund, the United Nations and Wells Fargo Securities, LLC

Conspicuous by its absence from the TPP is China.

Conspicuous by its absence from the TPP framework is China. As we have noted in previous reports, China is trying to enhance its international economic and financial clout through its sponsorship of a new multilateral development bank and the internationalization of its currency.[2] In our view, these moves by China are designed to move the global economy from an American-centric system toward one that is less dominated by the United States. Although TPP negotiations have been underway for years, China's recent moves may have given countries that are suspicious of Chinese intentions (e.g., the United States, Japan and some countries in Southeast Asia) incentive to deepen their own economic integration through expanded trade and investment.

Conclusion

The direct economic effects on the U.S. economy from eventual ratification of the TPP may be limited. The United States already has FTAs in place with 6 of the other 11 TPP signatories, so it is questionable how much further American trade with these countries will be enhanced by the TPP. With the notable exception of Japan, these five other non-FTA economies are rather small and none would be considered a major trading partner of the United States. Did the United States really go to all the trouble of negotiating the TPP just to get a FTA with Japan?

In our view, American motives should be viewed through a wider lens. The 12 TPP economies together account for one-third of global GDP and one-quarter of global trade. Unfettered access to these markets is attractive to economies that currently are not members. There currently are five other countries that are negotiating their own entry into the trade accord, and more countries will likely be induced to join as the ranks of TPP members rises. The TPP could be the catalyst that encourages TTIP negotiators to complete a free trade agreement between the United States and the European Union.

In the decades that immediately followed the Second World War, the United States led much of the world to reduce barriers to international trade. Successive American administrations viewed trade liberalization as a way to raise living standards in Western countries and cement them together as a bulwark against communism. Many analysts now view China as America's principal challenger for geopolitical dominance. The TPP, which will likely exclude China for the foreseeable future, may be America's answer to the rising economic and financial power of China.

[2] **See "China & the Asian Infrastructure Investment Bank" (April 16, 2015) and "Will China Soon Have an International Currency" (April 24, 2015). Both reports are available upon request.**

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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