

ECONOMIC VIEWPOINT



The New Trans-Pacific Partnership: Smaller, but Just as Ambitious

Canada recently signed the Comprehensive Progressive Agreement for Trans-Pacific Partnership (CPTPP), a free trade agreement with ten other nations representing 13.4% of the world's GDP, seven of which are new agreements. This *Economic Viewpoint* strives to present the agreement and its implications for Canada's economy. Although the benefits may be relatively slight for the overall economy, some sectors could gain, while others may be more disadvantaged.

Winding road to an agreement

Originally, the CPTPP,¹ formerly called the Trans-Pacific Partnership (TPP), included only New Zealand, Chile, Singapore and Brunei. After the agreement was concluded in 2005, the United States and other countries showed an interest, and gradually joined. The 12 countries managed to sign an agreement on February 4, 2016, in Auckland. However, the United States withdrew immediately after the last presidential election.

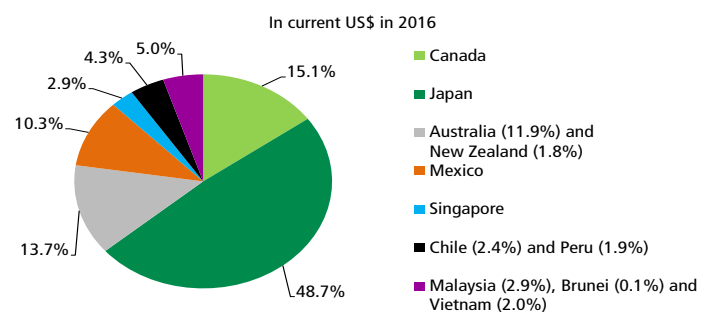
The 11 remaining members restarted negotiations in recent months, finally reaching an agreement on January 23rd, 2018. It was signed on March 8. Among other things, the partnership is intended to strengthen economic ties between members by lowering trade barriers and encouraging mutual investment. The text of the agreement is essentially the same as the 2016 version, with the exception of eliminated clauses on intellectual property and the dispute resolution mechanism. The parties also agreed on the possibility of expanding the agreement if other countries wished to join. Among others, the United States and United Kingdom recently showed a potential interest in signing on.

More indirectly, the CPTPP would also be a way for member nations to counterbalance China's economic power on the Asian continent. The agreement would help increase members' influence and bargaining power in the region by strengthening their political and economic ties.

A broad agreement

Now that the agreement is signed, it will only come into effect when at least six of the countries have ratified it, which could take several months. Once all 11 members have ratified it, the agreement will comprise about 6.7% of the world's population, and 13.4% of its GDP. In terms of output, Canada is the agreement's second largest economy, after Japan (graph 1). Brunei, Singapore, New Zealand, Australia, Malaysia, Vietnam and Japan represent new trade agreements for Canada, and offer the biggest potential gains, especially the last four countries. Canada had previously established free trade agreements with the other three CPTPP countries, i.e., the North American Free Trade Agreement (NAFTA) with Mexico (1994), and the free trade agreements with Chile (1997) and Peru (2009).

GRAPH 1
GDP of CPTPP members



CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership
Sources: World Bank and Desjardins, Economic Studies

¹ CPTPP members: Canada, New Zealand, Japan, Australia, Malaysia, Singapore, Vietnam, Brunei, Mexico, Chile and Peru.

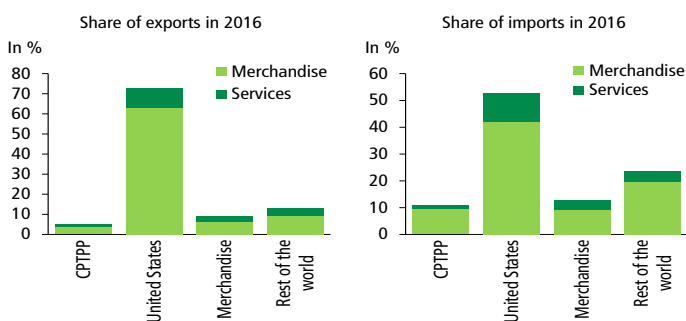
François Dupuis, Vice-President and Chief Economist • Carine Bergevin-Chammah, Economist

Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.
IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. The data on prices or margins are provided for information purposes and may be modified at any time, based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2018, Desjardins Group. All rights reserved.

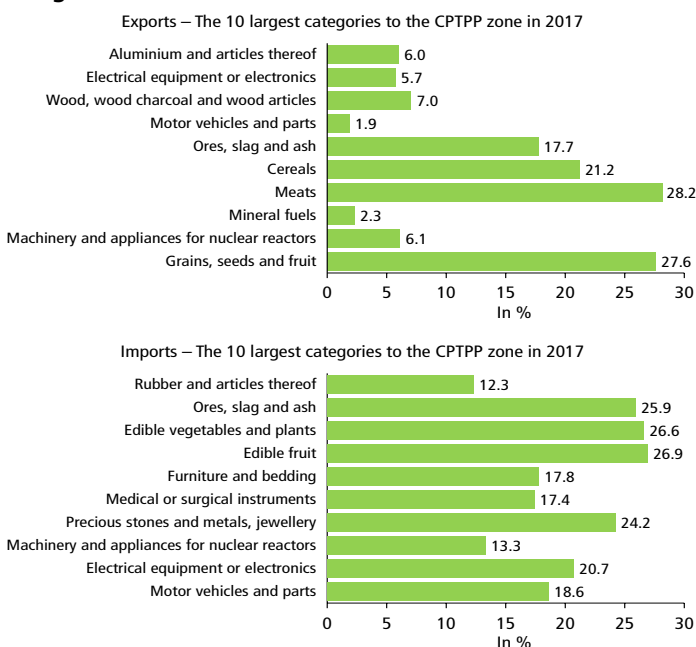
Overall, trade between Canada and the CPTPP zone is relatively small. Only 5% of Canada's goods and services exports went there, while only 11% of its imports came from CPTPP nations in 2016, for \$31.5B and \$73.5B respectively (graph 2). Japan was the main destination for these exports; based on purchasing power parity, it is currently the world's fourth largest economy. All in all, the CPTPP would nevertheless form Canada's third largest trade partner, behind NAFTA and the Comprehensive Economic and Trade Agreement with the European Union. Trade between Canada and CPTPP members primarily consisted of agricultural products—exported by Canada—and motor vehicles, electrical equipment and electronics—imported by Canada (graph 3).

GRAPH 2
Share of the CPTPP zone in Canada's international trade



CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership
Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 3
Share of CPTPP members in Canadian goods export and import categories



CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership
Sources: Statistics Canada and Desjardins, Economic Studies

The agreement aims to lower non-tariff barriers and eliminate 95% of the inter-country tariffs, about 90% at the time it is brought into force. It also addresses issues pertaining to dispute resolution, intellectual property, access to public markets and corporations, e-commerce, as well as labour and environmental standards.

Note that Canada already has free trade agreements with Mexico, Chile and Peru, so customs duties between these countries were already zero before the CPTPP. Moreover, Singapore does not levy tariffs on all of its trading partners, so Canada does not see any further tariff reductions with these countries. However, some gains are possible with greater liberalization of investment and the inclusion of chapters on various standards.

Gains that would be worth it

The Canadian government evaluates that, on the whole, the CPTPP will be good for the Canadian economy. According to its estimates, the new agreement would increase Canada's GDP by \$4.2B by 2040.² This does not seem like much, at first glance. It represents close to 0.2% of GDP in 2016, or \$191M a year. Although slight, the gains would still have a net positive impact; moreover, they do not include certain factors that are hard to assess and that could increase the benefit.

Also, the same Global Affairs Canada study deems that the agreement's economic impact will be better for Canada without the United States on board. It would give Canada a competitive edge over U.S. businesses in CPTPP nations while keeping Canadian businesses as competitive in the United States (table 1). The new agreement is also an opportunity for Canada to further diversify its international trade. That is a good thing, given the United States' dominance in Canada's trade relations in an

TABLE 1
Variation in Canadian exports by 2040 in relation to the base scenario according to various CPTPP scenarios*

DESTINATION	CHANGE UNDER THE CPTPP (\$M)	
	INCLUDING THE U.S.	EXCLUDING THE U.S.
Japan	1,346	1,767
Australia	664	689
Malaysia	234	200
Vietnam	206	271
New Zealand	110	123
Singapore and Brunei	93	100
Chile and Peru	14	26
Mexico	-504	-418
United States	-652	-268
TOTAL OF COUNTRIES ABOVE	1,511	2,490

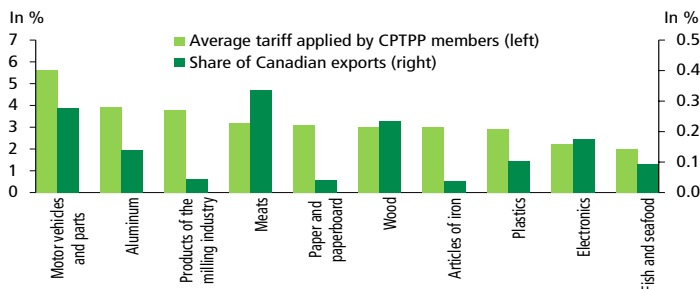
CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership; * Results of a simulation done by the Office of the Chief Economist at Global Affairs Canada.
Source: Global Affairs Canada

² *Economic impact of Canada's participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership*, Government of Canada, Global Affairs Canada, February 16, 2018.

environment where the surge in U.S. protectionism has recently created more uncertainty in Canadian markets.

More specifically, the main benefits would derive from the elimination of tariffs for Canadian companies that export goods and services to CPTPP nations (graph 4). According to the above-mentioned federal government study, these companies would avoid an estimated \$426M in tariffs a year, particularly in Japan, Malaysia and Vietnam, where customs rates are relatively high (table 2). Canadian products would therefore enjoy an advantageous position in these markets. If Canada were to be one of the first six CPTPP members to ratify it, it could access these markets as soon as the agreement goes into effect, and grab a bigger market share than the countries that are still in the process of ratifying. Some companies could also want to relocate into the CPTPP zone to benefit from the agreement's preferential rates.

GRAPH 4
Highest tariffs in the 25 biggest categories of exports to the CPTPP



CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership
Sources: World Trade Organization, Statistics Canada and Desjardins, Economic Studies

TABLE 2
Japan, Malaysia and Vietnam would be Canada's biggest opportunity for saving on tariffs

DESTINATION	AVERAGE TARIFFS APPLIED TO CANADIAN GOODS IN 2016 (IN %)	CANADIAN GOODS EXPORTS IN 2017 (IN \$M)
Vietnam	9.6	1,051
Malaysia	5.8	719
Japan	4.0	11,819
Australia	2.5	2,000
New Zealand	2.0	494
Brunei	1.2	3
Singapore	0.0	1,360
Mexico*	0.0	7,844
Chile*	0.0	885
Peru*	0.0	710

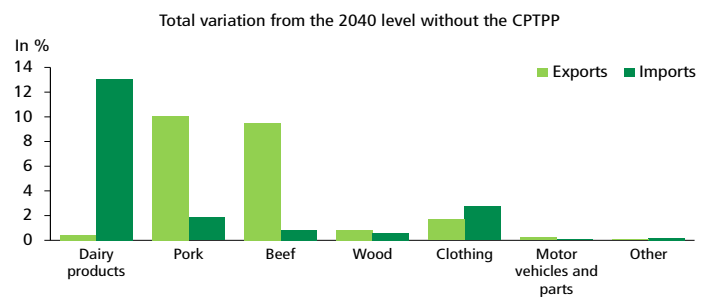
* Existing free trade agreements.
Sources: World Trade Organization, Statistics Canada and Desjardins, Economic Studies

However, Canada could lose market share in countries with which it has already established free trade agreements, since the other partners can now benefit from the same preferential rates. For example, Mexico, Chile and Peru could replace some of their

Canadian imports with goods and services from other CPTPP nations. The Canadian government's estimates show, however, that Canada's total exports to the CPTPP zone should increase.

In contrast, the removal of Canadian tariffs should push imports from CPTPP countries up. The increase could be partially offset by a drop in imports from the rest of the world and countries with which there are existing agreements, particularly the United States and Mexico. Some domestic producers could thus lose some of their Canadian market share in less competitive sectors (graph 5).

GRAPH 5
Some products could be especially impacted by the CPTPP*



CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership; * Results of a simulation done by the Office of the Chief Economist at Global Affairs Canada.
Source: Global Affairs Canada

Agriculture and forestry

Canadian agricultural and agri-food products headed for Japan, Vietnam and Malaysia would see the biggest tariff reductions. These three countries would, in particular, be an opportunity for Canadian meat and fish exporters. Major consumers, the Japanese, Vietnamese and Malaysian markets are still relatively closed for these products. Japan, Vietnam and Malaysia accounted for 34% of Canada's pork exports, and levied an average tariff of 12.9%. Canadian beef exports currently face average tariffs of 38.5% in Japan and 19.7% in Vietnam. Given that the two countries represented 4.8% of Canadian beef exports in 2017 and their consumption increased 3.7% and 4.5% in 2017 respectively, the agreement offers Canadian producers an attractive advantage. Of the CPTPP countries, Japan and Vietnam also charge the highest tariffs on fish and seafood, at 5.3% and 13.8% respectively; they accounted for 7.8% of Canada's exports in 2017.

Wood exports could also benefit from the CPTPP. The seven partners forming new free trade agreements with Canada tax Canadian wood products at an average rate of 4.3%. They accounted for 6.9% of Canada's exports, with Japan as the primary consumer.

Cereals are the fifth largest export to CPTPP members; Japan, Vietnam and Malaysia put an average tariff of 5.2% on Canadian

products. However, Canada has a 14.1% tax on this category; eliminating the tariff could push up imports from other major producers.

The dairy product sector could be the most affected as it would face more competition. With Canada's supply management mechanism, this industry is fairly sheltered from foreign imports. Under the CPTPP, however, members will receive quotas giving them access to 3.25% of the Canadian market, with no customs duties imposed on them.

Automotive

A rule of origin was included in the agreement for automotive products: at least 45% of the content must come from the CPTPP zone to be exempt from tariffs. Since the United States is excluded from the agreement, Canada cannot satisfy this ratio, given how heavily integrated the North American auto industry is. However, side letters with Australia and Malaysia would allow Canada to include less content, at 40%. Moreover, imports of assembled motor vehicles from the United States and Mexico would be partially replaced by Japanese vehicles, on which Canada currently levies an average tariff of 4.4%.

Textiles

Canadian consumers could see some savings with the elimination of tariffs on textiles and clothing from CPTPP countries. Canada acquires 9.4% of its textile and clothing imports from Vietnam and levies an average customs tariff of 15.2% on them. However, a rule of origin requires that the yarn and fabrics contained in textile products also come from the CPTPP region to benefit from the tariff waiver. Countries such as Vietnam may not be able to satisfy this requirement, which would minimize the agreement's impact on import prices for these products.

Services and other considerations

Aside from eliminating tariffs, the agreement lowers non-tariff barriers on services and investment. Although Canada is a net importer of services from the CPTPP area, its exports

could still benefit. In 2016, trade in services with agreement members accounted for 6.1% of Canada's exports of services in 2016, and 6.9% of imports. The agreement should also reduce the uncertainty surrounding trade relations between member countries, as they will be better structured and have a dispute resolution mechanism similar to that of the World Trade Organization.

A mechanism to resolve disputes between investors and governments will be introduced. Although more limited than the initial agreement, it should build confidence and promote foreign direct investment. Foreign direct investment between CPTPP members is already substantial, at \$122.2B in 2016, or 6.5% of bilateral direct investment in Canada. In 2016, close to 7.8% of Canada's direct investment occurred in CPTPP countries, while Japan is the sixth largest investor in Canada. Canadian businesses and investors may benefit from increased liberalization of investment, especially in countries that are experiencing strong growth, like Vietnam and Malaysia. The agreement would also encourage capital flows into Canada from member nations.

More broadly, consumers should profit from this new agreement. The elimination of customs tariffs should result in lower Canadian prices for goods from CPTPP nations, while Canadians could also enjoy a larger variety of products from the agreement zone.

Conclusion

The CPTPP agreement offers potential gains for Canada by expanding and diversifying its international trade structure. Overall, the agreement remains advantageous, although its impacts could be uneven in various sectors.

Carine Bergevin-Chammah, Economist