Beyond Latin America's trade divide

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MUCH HAS BEEN SAID and written about the growing contrast in trade policy between Latin America's Pacific and Atlantic sides. Mercosur, the region's largest trade bloc, is still beleaguered by trade disputes among its member states and outright violations of the bloc's rules, which certainly prevent the flourishing of a more proactive trade policy agenda. The Pacific Alliance, an incipient but promising initiative, seeks to build up commercial ties between the region's more open and market-friendly economies.

The distinction between the two sides is clear, but the line that currently divides Latin America will become blurred in coming years as the region contends with lower growth rates.

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For the more protectionist countries on the Atlantic side, inflationary pressures or the need to attract dollars into their economies will raise the cost of pursuing the active industrial policies often associated with protectionism, so although still lurking, trade protectionism will be pushed down the ladder of policy priorities. For the more open countries on the Pacific side, the challenge for leaders will be to rebalance trade relations with and better manage dependence on the two most important markets, the US and China.

While elections may influence and potentially alter each country's trade policy preferences—especially where significant political shifts have happened recently (Paraguay 2013; Chile 2014) or are expected to happen (Argentina 2015)— a more challenging macroeconomic environment is likely to usher in a period of less protectionism and more trade liberalization throughout the region, though at different intensities in different countries.

The Pacific Alliance will likely grow in coming years. While domestic politics will continue to matter, the trade policies in most countries already in the bloc will mostly be driven by global factors and the need to diversify exports. Much of the Alliance's potential to boost trade

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and attract new members will hinge on the success of US-led negotiations, such as the Trans-Pacific Partnership (TPP). The bloc's more open economies will seek reassurance about the benefits TPP may bring, in terms of both trade diversification and foreign investment. A successful TPP would enhance the potential of the Pacific Alliance and make it more attractive for other countries to join, especially the smaller ones in Central America and, less likely, Uruguay and Paraguay on the Southern Cone.

In the countries on the Atlantic side, domestic variables will have a much larger role in determining trade policy outcomes than in their Pacific Alliance neighbors. Over the years, trade policy in Brazil and Argentina has been subordinated to competing economic goals, chiefly regarding industrial policy. Other variables, such as concern over inflation, have also frequently interfered with a coherent trade policy. Rising inflation in Brazil and macroeconomic imbalance in Argentina may not signal a full-blown reversal of protectionist measures or a wholesale shift toward a more liberal trade negotiation agenda in the near term, but these trends strongly suggest that protectionism is waning as a serious policy option.

A wholesale shift in Mercosur's trade strategy in the medium term is still unlikely. However, a more challenging economic environment and the likely progress of mega-trade agreements like the TPP and the US Transatlantic Trade and Investment Partnership (TTIP) with the EU, have already prompted shifts in priorities for the bloc's members. Nearly 10 years after a first failed attempt, a Mercosur-EU deal is now within reach. While there continues to be resistance, Brazil is willing to present an offer encompassing nearly 90% of the country's total trade with the EU and rules on government procurement, services, and investments.

Ultimately, in the longer term these negotiations may help promote the idea of free trade within Mercosur countries. Besides creating a precedent for bending the bloc's rules, by allowing each country to liberalize trade at different speeds, a Mercosur-EU deal would also help demystify some traditional concerns that prevent these countries from liberalizing their economies, thus strengthening the still fragile pro-free trade lobbies in most of them. In Brazil, for example, recent support from the industrial sector for a free trade agenda represents an important change for a historically protectionist group.

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