The Road to Integration: the Pacific Alliance, the TPP, and Latin America

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INTRODUCTION

On February 10, 2014, Chile, Colombia, Mexico, and Peru—members of the so-called Pacific Alliance—agreed to eliminate tariffs on 92 percent of trade between their countries, while phasing out the remaining 8 percent over the coming years. The trade pact is an important step forward to synchronize member's trade commitments, with the aim of establishing the Alliance as the most attractive gateway for Asian companies exploring economic opportunities in Latin America.[1]

Politically, the Pacific Alliance polarizes a continent already divided between open and protectionist models.[2] Whether the Pacific Alliance can maintain the momentum for trade liberalization in the face of protectionist resistance and other challenges remains to be seen. Integrating Latin America's economies has been an elusive if not quixotic goal.[3] One thing is clear; advocates for trade liberalization are hoping the Pacific Alliance succeeds.

WHAT IS THE PACIFIC ALLIANCE?

After the demise of the Free Trade Area of the Americas (FTAA) a decade ago, due to opposition from Brazil and by much of the rest of Latin America, and the subsequent collapse of the Doha Development Round in the World Trade Organization (WTO) in 2008, some of Latin America's most trade-oriented countries focused on establishing a series of bilateral free-trade agreements (FTAs) with the United States, the European Union and, increasingly Asian countries.[4] Indeed, Chile, Colombia, Mexico, and Peru created their own free-trade area in June 2012, named the Pacific Alliance, while Brazil and Venezuela prioritized political over economic integration, leading to the establishment of various regional organizations like UNASUR and CELAC, which have not fostered a significant and sustainable expansion of economic ties between Latin American countries.[5]

The objectives of the Pacific Alliance include developing an economically integrated regional bloc gradually moving toward "the free movement of goods, services, capital and persons."[6] In other words, the countries want to create regional value chains (a single good and its inputs can travel through multiple countries during assembly) to diversify their exports and increase economies of scale, which lower the average cost of production below what any country could achieve alone. The group also aims to, "become a platform for economic and commercial integration as well as political coordination with global outreach, particularly towards the Asia Pacific."[7]

According to the WTO, the agreement creates a market of 210 million people, bigger than Brazil, with a combined economic output equal to 36% of the total GDP of Latin America, and half of the region's global trade. If the Alliance were a country, it would be the world's eighth-largest economy and seventh-largest exporter. There is also the potential for the Pacific Alliance to grow as other countries have expressed interest in joining the group. The bloc is emerging as a pragmatic alternative for smaller Latin American countries to the more political groupings dominated by Brazil and Venezuela; eight have observer status and Costa Rica has applied to be a member.[8] 21 nations outside the region, including the United States, Australia, Canada, Finland, India, and New Zealand have also been granted observer status in the body.

HOW IS THE PACIFIC ALLIANCE DIFFERENT THAN OTHER REGIONAL PACTS IN LATIN AMERICA?

As noted above, the Pacific Alliance has made significant progress in removing tariffs and rules of origin that have blocked the development of regional economies of scale in many sectors. But the goal of the Pacific Alliance is to go beyond traditional free trade deals. So far, the countries have dropped business and tourist visa requirements, and have created joint trade missions in Asia and Africa.[10] In the financial sector, Chile, Colombia, and Peru formed the Integrated Latin American Market (MILA) in 2011 to link their stock markets so that a company listed in one can be traded in the other two. MILA is already the second-largest bourse in the region after Brazil, and will become the largest if/when Mexico joins later this year (financial and legal reforms introduced by Mexico's President Enrique Peña Nieto should speed up the process).[11]

Finally, unlike other Latin American groups, the Pacific Alliance was formed with the explicit purpose to establish closer relations with the Asia-Pacific region.[12] In the years before the start of the Pacific Alliance, the four countries had already started engaging with Asian countries independently. Chile and Peru have signed agreements with China and South Korea; Chile and Mexico have negotiated FTAs with Japan; and Colombia recently signed an FTA with South Korea and is in negotiations with Japan. But the Alliance enables the member countries to formulate coherent trade policy choices as they pursue new economic opportunities with Asian markets, and strengthens their international standing in terms of bargaining power relative to larger countries like China.[13]

Chile, Colombia, Mexico and Peru have also stabilized their macroeconomic foundations, and are more likely to attract foreign investment from Asia than their regional counterparts. They boast the region's highest economic-growth rates, and enjoy low inflation and healthy foreign reserves. According to the World Bank, it is easier to do business in these four countries than it is anywhere else in Latin America.

The market-led Pacific Alliance contrasts sharply with the more statist Mercosur, an economic and political agreement launched in 1991 between Argentina, Brazil, Paraguay, and Uruguay (Venezuela joined the bloc in 2012). While the Brazil-dominated group showed promise in the 1990s by reducing tariffs and other barriers to trade, formulating a common trade policy and participating actively in FTAA negotiations, the group is somewhat paralyzed, as differing political and economic agendas between its members have undermined their integration.[14] In fact, trade among Mercosur members peaked 15 years ago, when exports within the block was about 25% of the countries' combined trade. Intra-regional exports have fallen off since then, amounting to around 15% over the past decade.[15]

Mercosur has also not engaged in the type of trade expansion seen by Pacific Alliance countries (after all, Brazil views regionalism and integration as tools to protect against the dangers of globalization, e.g., external shocks, by retaining open markets for its exports).[16] In the past 13 years more than 350 trade deals were registered at the WTO. But Mercosur signed just four, with Peru, Egypt, Israel and the Palestinian Authority. Negotiations with the European Union to establish a liberalized trade agreement have dragged on for 15 years, the most recent delays due to Argentina's reluctance to open its domestic market.[17] As a result, Mercosur has preferential trade access to less than 7% of global markets, while Pacific Alliance countries on average have trade pacts with countries representing almost 75% of the world economy.[18]

Instead, Mercosur has decided to focus on political issues, rather than attempt to deepen economic ties among its members. For example, Mercosur in 2012 admitted Venezuela (then governed by Hugo Chávez), and suspended Paraguay (which was blocking Venezuela's full membership in the bloc) after its left-wing president was impeached.[19] Brazil and Venezuela have also backed two regional integration projects—the Union of South American Nations (UNASUR) and the Community of Latin American Caribbean States (CELAC)—that explicitly exclude the United States and Canada (Mexico was also excluded from UNASUR because it belonged to the North American Free Trade Agreement (NAFTA), its free trade agreement with the United States and Canada).[20]

The economic situation of the Mercosur countries is similarly dire. Argentina is facing the real possibility of sovereign default, and Venezuela is plunging deeper into economic chaos (inflation skyrocketed to 56% last year).[21] The Brazilian economy is in recession and 2014 will mark its fourth consecutive year of sluggish growth (economists expect Brazil's economy to grow as little as 1.5% this year).[22] However, unlike Argentina and Venezuela, Brazil's disappointing growth has more to do with a lack of diversification than blatant economic mismanagement.[23] As China's growth has slowed, and the demand for Brazilian soy and iron ore has declined, the country has found itself without an external engine for its economy.[24] Moreover, according to Global Trade Alert, a website that tracks trade protection since the global economic crisis, Brazil is the second most protectionist country in Latin America, measured by the number of protectionist measures employed from 2008-2013 (Argentina and Venezuela rank firstand fourth respectively in the same time period).

WHAT ROLE DOES THE PACIFIC ALLIANCE HAVE WITHIN BROADER APEC AND TRANS-PACIFIC PARTNERSHIP (TPP) NEGOTIATIONS?

There is an overlap between the Pacific Alliance and the much larger TPP. Both initiatives seek to bridge the Americas with Asia and create Pacific-based trade blocs. Indeed, the

Pacific Alliance could be a stepping-stone for small countries like Costa Rica to integrate faster into TPP and other multilateral agreements (if TPP negotiations drag on, the Alliance could open up trade with Asia sooner).[25] Both initiatives aim to go beyond the reduction of traditional trade barriers to address so-called "deep integration" issues, including financial regulation, environmental laws and competition policy.

Nevertheless, some aspects of the relationship between the Pacific Alliance and the TPP remain unclear. The opportunity for Chile, Mexico, and Peru to be a part of TPP is a momentous step in further promoting the economic growth of these economies, and may be raise the economic profile of the Pacific Alliance. However, Colombia (the remaining Pacific Alliance member) is currently not participating in TPP because it is not a member of the Asia Pacific Economic Cooperation (APEC) forum.[26] While membership in APEC is not an official prerequisite to participate in TPP, member states have expressed their reluctance to consider new TPP members excluded from APEC membership.[27] Colombia has tried to become a member of APEC since 1995 and has formally expressed interest in joining TPP negotiations, but has not yet been admitted to the group. Unless, entry into TPP is extended beyond APEC members, Colombia will be left out, which will inhibit the members of the Pacific Alliance from operating as a cohesive unit within TPP.[28]

The United States could push to include Colombia and other Latin American countries in TPP. But the Obama Administration is unlikely to support broader Latin American participation in the TPP until after a deal is finalized due to the delicate nature of the negotiations.[29]

From the point of view of the United States, the purpose of TPP is also as much about setting a new standard for trade reform as it is about expanding trade opportunities between participating countries. Precedents developed in TPP could become a foundation for new initiatives to revive the multilateral trade talks in the WTO.[30] But leaving some countries with FTAs out of TPP undermines US efforts to, among other things, set the highest possible standards on labor and environmental protections through the trade accord. For example, China's growing economic presence in the Americas enables Latin American and Caribbean nations to sign similar agreements with China that do not include similar provisions.[31] While China's FTAs with Chile and Peru liberalize agriculture and markets for lower value-added manufactured goods, they do not include strong labor and environmental protections. Essentially, not all trade agreements are created equal.[32]

In addition, some analysts question whether the Pacific Alliance and TPP are compatible with each other.[33] The TPP is designed to strengthen the existing economic relationship between Latin America and Asia, based largely on the exchange of natural resources for a bevy of manufactured goods, and ideally, through enhancing trade in a variety of other sectors. However, given China's high demand for natural resources, TPP could magnify the dependence in Chile and Peru on extractive industries to generate export earnings, without complementary policies to diversify production and create new trade opportunities.[34] For example, copper and iron ore accounted for 80% of Chile's exports to Asia between 2002 and 2012, while manufactured products made up a mere 8%. Conversely, metals and ores comprised only 1/3 of Chile's exports to the rest of Latin America, while manufactured goods made up almost half of its regional exports. Based on this data, the best chance to diversify exports lies in deepening intra-regional trade, which is exactly what the Pacific Alliance aims to achieve.[35]

Finally, as mentioned previously, TPP aims to set the standard for trade reform not just for the Asia-Pacific Region, but also for the global trading system. Yet precedents set through TPP could restrict the ability of Pacific Alliance governments to pursue policies to increase linkages between their economies enough to create regional production chains that are necessary to achieve economies of scale like the development of standardized rules for labelling.[36] Or a foreign investor could challenge public-spirited policies under TPP's investor-state dispute settlement mechanism.[37]

WHAT ARE THE CHALLENGES AND OPPORTUNITIES FOR THE PACIFIC ALLIANCE IN THE FUTURE?

The Pacific Alliance has accomplished a lot in a short period of time to tie the economies of Chile, Colombia, Mexico, and Peru closer together, and has the potential to emerge as the primary Latin American economic interlocutor for Asia. It may even force Brazil to reformulate its trade policy objectives in Latin America and in the global arena. If not, Brazil may end up isolated from the real world of global trade and investment.[38]

Still, significant obstacles lie ahead. Even though the Pacific Alliance countries have eliminated tariffs for 92% of their trade, the remaining 8% cover politically sensitive sectors, including agriculture, textiles, and garments, which can prolong tariff reduction negotiations indefinitely.[39]

And then there's infrastructure and the region's size. The new trade agreement won't help the countries develop roads, bridges, ports and airports to increase productivity.[40] The region's transport infrastructure will require billions of dollars of investment to match the level of the world's most competitive economies. For example, shipping a container from Bogotá to the port of Barranquilla (both located in Colombia) is three times the cost of shipping it from Barranquilla to Hong Kong, while Santiago is about as far away from Mexico City as London is from Nairobi.[41] Geography partially explains why Latin American countries are not big trading partners with each other. According to the WTO, only 27% of all Latin American exports go to other countries in the region. By comparison, 70% of European exports remain in Europe, and half of all Asian and North American exports are bought by neighboring countries.

There could also be some growing pains. The Pacific Alliance's initial success is largely due to the fact that Chile, Colombia, Mexico, and Peru generally embrace free trade and open markets; they are "like-minded".[42] Indeed, one requirement to become a member is to have trade agreements with each of the existing member countries. But as membership expands, fault lines could emerge. For example, Panama's integration with the Alliance could get held up due to tax haven laws. US membership is also problematic because the agreement provides for the free movement of people between member countries, and US observers have raised concerns that some people may use the agreement to migrate easily to the United States.[43]

Politics can also stymie integration efforts. For example, Chile recently elected a new president, the left-leaning Michelle Bachelet, and she might not be as committed to the Pacific Alliance as her predecessor. Bachelet won reelection on a platform that prioritized social policies to address the deep divide between rich and poor in Chile over free trade and economic integration (Chile has the highest income inequality among Organization for Economic Co-operation and Development (OECD)) members.[44] Yet it is unlikely that Chile will withdraw from the Pacific Alliance. International trade has been a key driver of economic growth in Chile, and solidifying connections with Asia can only bring more economic benefits to the country.[45]

Actually, Chile recently suggested that the Pacific Alliance and Mercosur should consider integration even though the attitude to free trade between the two groups is very different.[46] Leaders of Latin America's more political and anti-American groups do not like the Alliance. Evo Morales, the president of Bolivia claimed that the Pacific Alliance is a plot by Washington to divide UNASUR. Ecuador's Rafael Correa dismissed it as "more neoliberalism," while the former Brazilian President Luiz Inácio Lula da Silva criticized the Alliance as a return of the much-derided Washington Consensus to South America. For their part, the Pacific Alliance countries insist that the initiative is simply an economic arrangement to promote trade and investment.[47]

In the end, the economic results from the different trade blocs will set the trade priorities of Brazil and the other Mercosur countries. If the economies of the four member countries of the Pacific Alliance continue to grow, and growth elsewhere in Latin America starts to slow, Mercosur may feel pressure to seek economic rapprochement with its neighbors, and pursue deals not just with the European Union, but also the United States. These countries may also try to bypass Mercosur and pursue different trade agreements if they are not able to resolve their differences. Uruguay has long wanted a trade agreement with the United States, and Brazil is prepared to negotiate a bilateral trade deal with the European Union if Argentina continues to cause problems.[48]

CONCLUSION

The Pacific Alliance has generated a lot of excitement from supporters of trade liberalization and Latin Americanists alike. The potential to expand trade and investment flows between the four countries is huge. The initiative also has the potential to raise the economic profile of the region with the rest of the world, especially Asia. But the road to integrate their economies won't be easy for the Pacific Alliance. Doing away with trade barriers for politically sensitive sectors will be difficult, not to mention the challenges posed by geography to the creation of seamless supply chains.

Politics could also derail the integration process. Chile recently elected a new president and Colombia's elections are coming up in May; Peru's take place in 2016. The new presidents may not be as committed to the Pacific Alliance as their predecessors. Public support for new trade rules will erode if the countries' economies begin to slow down.

Finally, the relationship between the Pacific Alliance and the TPP is not well defined. Overlapping trade agreements and commitments between Chile, Colombia, Mexico, and Peru may prevent both initiatives from functioning fully; it could also cause friction in trade relationships.[49]

"It is easy to list the reasons why the Pacific Alliance might amount to nothing," wrote Moisés Naím, at the Carnegie Endowment for International Peace in Washington, recently. "But the list of incentives these countries have to make it succeed are bigger still."[50]

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