A tale of two worlds

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Latin America is splitting down the middle. Along its eastern coast, the Mercosur trading bloc and customs union, which comprises Argentina, Brazil, Paraguay, Uruguay and Venezuela, sports a fairly strong protectionist tilt. Along the western coast, the *Alianza del Pacífico*, which includes Chile, Colombia, Mexico, Peru and, soon, Costa Rica, goes for total openness. Which bloc shows the most promise?

Both blocs are the culmination of more than a century of efforts to foster economic regional integration. At first sight, Latin American nations should have several advantages over other areas, such as the European Union, that have eventually managed to overcome national instincts to form a common market: shared heritage, culture, the same dominant religion, and vast natural riches. Fruitful economic and political cooperation would appear all but assured.

Alas, it has not quite worked out that way. Ill-conceived economic policies, mutual distrust and the occasional strife have led to backwardness and a permanent trailing position for Latin America in the global development league.

The forerunners

To overcome this economic backwardness, Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay launched the Latin American Association for Free Trade (ALALC, in its Spanish acronym) in 1960. Twenty years later it became the American Association for Integration (LAIA or ALADI), with the inclusion of Colombia, Ecuador, Bolivia and Venezuela. Panama and Cuba joined later on.

ALADI never lived up to its stated goal of *"…creating an area of economic preferences with the final objective of establishing a common market in Latin America."* But it has at least served as an instrument for the exchange of trade preferences between member countries under the framework of the so-called *Acuerdos de Complementación Económica* (Economic Complementation Agreements), most of which are currently in place.

A further effort was Andean (or *Comunidad Andina de Naciones*, CAN, in its Spanish acronym). Established in 1969 by Bolivia, Chile, Colombia, Ecuador, and Peru and later joined by Venezuela, its main objective was to create a single economic space where goods and services could flow freely amongst its members, while erecting a common external tariff to protect them against foreign competition. This meant that in practice it ended up replicating the industrial policies of individual members that still adhered to the tenets of import substitution.

Furthermore, the member countries pursued conflicting economic policies that included central planning for various industries, such as petrochemicals, steel, automobiles, and chemicals, among others. While it did manage to adopt one set of common rules, for the treatment of foreign direct investment (FDI), it unfortunately was of a markedly discriminatory nature.

Despite its commitment to erecting a protective common external tariff, innumerable negotiation rounds failed to bring agreement on the criteria for establishing it. And while it proclaimed many commitments to lowering inter-member tariffs towards the establishment of a free trade zone, these were systematically torpedoed by delays or went routinely unfulfilled. By the mid-1970s Chile, engaged in a general liberalization of its economy, voiced severe objections to its partners' views on tariff levels and the treatment of FDI. These objections ended with Chile leaving Andean in 1976.

The above notwithstanding, Andean has been able to survive as an institution, but has been vastly debilitated, particularly after Colombia and Peru started to adopt many liberalizing policies that adhered to the so-called 'Washington Consensus'. When these two countries announced that they intended to negotiate a free trade agreement with the United States, Venezuelan President Hugo Chávez was so enraged that he decided to pull Venezuela out of Andean in 2006; he later made it join Mercosur. Bolivia, in turn, despite its similar misgivings about Andean, decided to stay in, but also to pursue a membership in Mercosur, to which it is ideologically closer.

Surprisingly, in light of the above setbacks, Andean was able to put into effect a free trade zone (FTZ) of sorts in 2005, although ditching the idea of a customs union with a common external tariff. It also developed a vibrant and successful financial arm, the Andean Development Corporation (CAF).

Mercosur

The *Mercado Común del Sur*, Mercosur, came into being in 1985, with the signing of the Argentina-Brazil Integration and Economics Cooperation Program, and became formally established in 1991 by the Treaty of Asunción. Fairly ambitious on paper, it not only aimed at promoting free trade and the free movement of goods, people, and capital, but even posited a common currency and a common parliament. The currency never came around, but the other goals have been attained, at least in part.

The large domestic markets of Brazil and Argentina have allowed the five-member Mercosur, with a total population of 300 million and an aggregate GDP of approximately US$3.2 trillion, to build an important trading bloc, albeit relatively closed to the rest of the world. Its external tariff affords substantial protection against imports from non-member countries, but allows member countries waivers from applying the common external tariff schedule on a number of tariff lines corresponding to "sensitive" products.

Most of the hurdles encountered by Mercosur are the same ones that thwarted Andean: the attempt to create a trading bloc conceived as a fortress against competing third-country imports, compounded by an inability to coordinate macroeconomic policies and by recurring periods of domestic economic crisis and external economic shock. In addition, over the years their various member countries have substantially altered their economic models.

For example, Argentina adopted for a decade a currency board, pegging its local currency to the dollar as a means of ending hyperinflation, and later hobbled its economy by ill-thought economic measures such as raiding the central bank reserves to finance budget deficits or the imposition of steep export levies on agricultural products. It has also doctored its inflation figures and alienated the international capital markets.

Venezuela, in turn, turned into an astonishingly incompetent state-run planned economy, with nationalization of industries and the imposition of price controls on many goods and several parallel exchange rates. Brazil undertook a vast monetary reform including the introduction of a new currency and the move from a fixed exchange rate regime to a floating one. Paraguay was suspended in 2012 for the violation of Mercosur's Democratic Clause, after its parliament impeached President Fernando Lugo. Not surprisingly, all these factors have often resulted in severe clashes between member countries.

The Mercosur partners, while engaging in trade negotiations with the US and Europe, have so far remained committed to protecting their large aggregate domestic market against external competition. It has not really helped: the share of intra-Mercosur exports fell from 19.5% a 15% of total exports between 1995 and 2012, and overall Mercosur growth has been tepid.

Not only economic factors have contrived against regional economic integration. Ideological and geopolitical elements have also played a crucial role. The initiative of President George W Bush to launch a Free Trade Area of the Americas (FTAA) was met with widely divergent reactions in Latin America. Countries like Chile, Colombia, and Peru as well as most of Central America view FTAA positively. Brazil, on the other hand, initially welcomed FTAA and participated in the negotiations, but later

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entered into conflict with the United States over such issues as US domestic agricultural support prices and export subsidies.

Other countries simply shunned the initiative. For Venezuela's Hugo Chávez, the FTAA was simply another form of neo-imperialism. He soon commanded the establishment of the Bolivarian Alternative for the Americas (which shortly thereafter changed its name to Bolivarian Association for the Americas, ALBA in its Spanish acronym). Formally established in 2004, in also includes Bolivia, Cuba, Ecuador, Nicaragua, Venezuela and several small Caribbean countries.

Thus, Latin America's efforts towards successful regional integration have been fraught with political instability, sharp swings in economic policies and the lack of a consistent vision to guide the design of industrial policies. It is no surprise that Latin America has not managed to set up value chains that make good use of its comparative advantages. Intraregional trade is low (20% in 2012), far lower than Asia (26%, same year) or the European Union (63%, also same year). Trade within the regional blocs is even lower than the overall regional average.

This is, hopefully, about to change.

The big divide

It is ironic that the swerve towards more enlightened economic policy was ushered in by highly unlikely champions of free trade, such as dictator Augusto Pinochet in Chile and authoritarian president Alberto Fujimori in Peru. Even more remarkably, Fujimori's liberalizing policies were continued by Alan García, whose illiberal economic policies had failed miserably during his first term, which preceded Fujimori's, as well as by García's successors. Peru, as a result, went from being a closed economy to the most open economy in Latin America, boasting the fastest growth in Latin America for many years.

The forerunner was Chile. Over the past 40 years, it has perhaps been the only country in the region consistently to adhere to the remarkably open trade and industrial policies first introduced in

Free-trade agreements of *Alianza del Pacífico* countries with AdP observers and other third countries

	Chile*		Colombia		Costa Rica		Mexico*		Peru*	
	Year of entry into force	Depth	Year of entry into force	Depth	Year of entry into force	Depth	Year of entry into force	Depth	Year of entry into force	Depth
Canada*	1996	(5)	2008	(6)	2002	(4)	1994	(7)	2008	(6)
United States*	2004	(6)	2012	(7)	2009	(6)	1994	(7)	2009	(7)
China	2006	(3)			2011				2010	(5)
India	2007	(1)								
Japan*	2007	(7)					2005	(6)	2012	
Singapore*	2006	(6)			2013				2009	(6)
South Korea	2004	(7)	2013						2011	
Australia*	2009	(7)								
New Zealand*	2006	(6)								
European Union	2003	(6)	2013		2013		2000	(3)	2013	
Switzerland	2004	(6)	2011	(7)			2001	(7)	2011	
Turkey	2011	(2)								
Israel			2013				2000	(4)		
Morocco										
Iceland	2004	(6)	2011	(7)			2001	(7)	2011	
Norway	2004	(6)	2011	(7)			2001	(7)	2011	
Brunei Darussalam*	2006	(6)								
Indonesia										
Malaysia*	2012									
Thailand									2011	(1)
Viet Nam*	2012									

*Source: Data from WTO RTA Gateway and Dür et al. (2014); visualization by Abusada-Salah et al. (2014). Depth is a measure of how profound each bilateral agreement is, with 1 very shallow and 7 very deep, ie. going beyond tariffs to include non-tariff barriers and regulations. * indicates parties to the negotiations of the Trans-Pacific Partnership TPP. Blue background indicates treaty under negotiation*

the early years of the Pinochet dictatorship. The most astounding proof of this commitment came when Pinochet stepped down in 1990 and the incoming democratic government decided to keep to such policies. This continuity was again put to the test during the first tenure of President Michelle Bachelet, when Brazil and Argentina tried to attract Chile to Mercosur. Chilean authorities pointed to the difficulties of joining a bloc relatively closed to foreign competition and where member countries still exhibited significant macroeconomic imbalances.

Chile went on to enhance trade relations with Latin America, NAFTA, the EU and Asia. Worryingly, however, the same President Bachelet, now in her second term, appears to be about to undo much of the good work with the introduction of modifications to the minimum wage rules and to the defined-contribution pension plan, as well as a seven-percentage-point hike in corporate taxation.

Mexico's trade policies have gained consistency since the coming into effect of the trilateral North America Free Trade Agreement (NAFTA) in 1994. The overwhelming importance for Mexico of economic relations within North America (almost 80% of its exports go to the US) has inevitably swayed the focus of Mexican trade relations away from the rest of Latin America. Nevertheless, Mexico has tried to increase its trade relations with Latin America and the Caribbean through the signing of many trade accords. Still, Mexico's trade with the countries to the south has remained limited, at around 7% of its total exports and less than 5% of its imports.

Colombia, in turn, despite its massive security problems (US Secretary of State John Kerry named Colombia in the same breath with the Central African Republic and the Democratic Republic of Congo as places where strife needs to be curbed, at the Security Conference in Munich this February), has made astonishing progress towards liberalizing its economy. It is now one of the world's fastest-growing economies.

Thus, by the end of the 2000s Latin American trade policies were clearly diverging into two separate paths. On the Atlantic side, the fairly protectionist and distrustful of globalization Mercosur bloc, intent on preserving its huge internal market. (Here, by the way, Uruguay is clearly the odd man out, with an economic and political stance that would fit beautifully with the Pacific countries; as it is, sandwiched between the two local mammoths, it didn't really have much of a choice.)

On the Pacific side, all countries (with the exception of Ecuador, which would fit ideologically well in Mercosur) had instead opted for what has been termed 'open regionalism,' which aims at deep integration at the regional level and an opening to the entire world. Each member country is free to enter into free-trade agreements with whomever they want. Even with Mercosur. The political will, clearly, was to give economics a chance.

Chile, Mexico and Peru have become members of the Trans-Pacific Partnership (TPP) and of the Asia-Pacific Cooperation (APEC) forum. Colombia later signed FTAs with the EU, Canada and South Korea. Furthermore, Chile and Mexico are members of the Organization for Economic Development and Cooperation (OECD); in 2013 Colombia launched its own accession process, and Peru has announced it will follow suit.

So, in light of the similarities in trade policies of these countries on the Latin American Pacific coast, Colombia proposed in 2006 the establishment of a forum for cooperation and coordination called *Arco del Pacifico* (Arc of the Pacific). The idea was endorsed by Chile, Mexico and Peru and in 2007 was formally established with the participation of Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Peru. It failed because of a lack of commitment and divergence of trade policy interests.

It was the formerly economically illiberal Peruvian President Alan García who, in 2010, suggested that Chile, Colombia and Peru should start a process to build what he called a 'profound integration' aimed at going beyond the usual disciplines or chapters included in FTAs to include a deeper coordination of public policies, building upon the already existing similarities of such policies in the three countries. García's proposal was met with immediate enthusiasm by the other two presidents. Later, the Mexican government requested to join the Group and in April 2011, finally, the Pacific Alliance (or *Alianza del Pacifico*, AdP) was officially created in Lima.

Its stated objectives are the construction of an area within which there will be free movement of goods, services, capital and persons, with the purpose of *"attaining greater welfare, overcoming socio-economic inequality and achieving greater social inclusion of their inhabitants"* and becoming *"…a platform for political articulation and economic and trade integration, and to project these strengths to the rest of the world, with a special focus on Asia-Pacific".*

Negotiations within the Alliance have proceeded at a vertiginous pace. Since its inception in April 2011, the member countries have celebrated nine leaders' summits and negotiated two important agreements. The first of them was the Framework Agreement of June 2012, which contains the legal basis that laid the foundations for the Pacific Alliance. The second was an Additional Protocol, signed in February 2014, which goes beyond tariff liberalization to include the harmonization of rules of origin, and covers non-tariff barriers, such as sanitary and phytosanitary and technical barriers to trade among its members. The Additional Protocol also contains clauses on government procurement, trade facilitation, investment, financial services, maritime services, e-trade, telecommunication, dispute resolution and transparency.

In terms of trade liberalization, the Pacific Alliance offers a small yet significant improvement vis-à-vis the agreements previously signed among its members. Bilateral FTAs among the Alliance members had already liberalized over 92% of the total trade. Once the liberalization schedule is completed, over 99% of trade will be free of tariffs and duties. Additional actions have already been taken in other areas, such as those regarding the merger of stock exchanges and the facilitation of movement of businessmen and people in general. There are no tourist and business visa requirements for Alliance citizens, and special programs are in place to make it easier for our students to study and travel.

Crucially, the Alliance opens the possibility for its members to collaborate in the areas of science, technology and the development of human capital, in order to enhance their competitiveness in global value chains with more diversified and technologically advanced products and services.

The open regionalism concept, as well as the political will that the leaders are wielding in its construction, has elicited worldwide interest, as witnessed by the 32 countries that now have observer status within the Alliance. In addition to Costa Rica, Panama is also an official candidate for membership. It is also significant that the Alliance can act with a single voice within the TPP and other trading bloc negotiations.

The current four member countries represent 214 million people, with a combined gross domestic product of US$2.1 trillion, and accounts for 37 percent of Latin America's total GDP. Over the past four years, their annual growth rate has averaged 5.1 percent. Alliance foreign trade adds up to more than US$1.13 trillion, and it is the recipient of 45 percent of total foreign investment flows in Latin America.

The member's stock exchanges are unified in the Latin American Integrated Market, listing more than 750 companies, with a market value of US$1.1 trillion. The members are busy establishing embassies and trade offices in shared facilities overseas.

Thus, in South America, the Andes mountains not only mark a mighty geographic division, but an economic policy one as well. You would do well to go west, young man. ■

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