EMERGING MARKETS

THE PACIFIC ALLIANCE

PERSPECTIVES & OPPORTUNITIES FOR LATIN AMERICA

Edited by Mario Torres Jarrín & Jonathan Violante Pica

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Mario Torres Jarrín
Jonathan Violante Pica
(Editors)

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INTRODUCTION

This book is the result of the collaboration, in the framework of the European Institute of International Studies, between two Research Groups of outstanding experts and personalities, to whom I would like to express my sincere gratitude and thanks for their excellent work.

The first Research Group on Inter-regional dialogue and Global Governance has been responsible for the study and analysis of the impact of the regional integration processes in international relations and its consequences on global governance.

The second Research Group on Finance and the Private Sector has been focused on the different dynamics that are related to economic growth, delving into areas such as entrepreneurship and innovation, corporate governance, access to financial services and the business environment in general, together with the inter-linkages that tie such financial developments to financial regulation and geopolitical developments.

At the same time, both Groups present research projects with a well-informed insight, as well as recommendations and initiatives towards action with the final aim of promoting sustainable development, education and reduction of poverty.

The Pacific Alliance is a relatively new initiative by Colombia, Mexico, Peru and Chile; countries that seek to create a new process of regional integration in Latin America and the Caribbean. Such a process is to be based in a shared vision of political economy and free trade as a model of development. The Pacific Alliance intends to implement a deep integration of services, capitals, investment and flow of people. It is defined as an open and non-exclusionary process of integration. In 2015, the Pacific Alliance received almost half of the $159 bn dollars of foreign direct investment within the Latin American and the Caribbean region. Over its short history, the Pacific Alliance has effectively dragged positive attention among other emerging markets as a stable and democratic region with great potential in several different fields.

As its own name indicates, the Alliance has expressed a particular emphasis in the Asia-Pacific region, and is working effectively at promoting increased participation in global value chains.

The four Member countries together comprise a population of around 216 million people, representing 3% of the world population, with an average GDP per capita of USD 9,910 and an average unemployment rate of 6.6%. This means that the Pacific Alliance is not only an interesting producer, but also a very important consumer market in globally, constituted mainly by a young population with a qualified labor force as well as an attractive subset of consumers whose purchase power is constantly increasing. Furthermore, since the launch of the Pacific Alliance in 2012, the initiative has gained increasing economic importance and political attention. Today, not only Heads of State, but also other key policy makers, such as Ministers of Finance, meet yearly in order to consolidate a region for trade, well-being, inclusiveness, innovation and competitiveness. Demographic transitions in more industrialized economies present potential opportunities for technological transfers between the Pacific Alliance and these countries in order to shift technology while profiting from mutual expertise. It is expected that the increase in commerce in the Pacific Alliance will generate jobs and stimulate consumption both domestically and internationally, hence making the member countries an important world market with an integrated financial system.

This book delves into the Pacific Alliance from different perspectives, including the realms of foreign diplomacy, economy, politics and technological aspects, whilst analyzing the opportunities that may occur during this process of regional integration.

Today, 49 countries from all around the world have expressed their interest in the Pacific Alliance by obtaining observer status. The Pacific Alliance's pragmatic approach towards economic integration has allowed for great advances. An example is the elimination of 90% of tariffs on intra-trade goods, agreed by the High Level Group and implemented at the beginning of 2013, followed by a liberalization of a further 2% agreed upon in 2014. Another cornerstone achievement is the launch of the Latin American Integrated Market (MILA), increasing the opportunities for access to finance sources within the region. Nevertheless, significant challenges remain for member countries. Increasing the current low levels of intra-trade among the member countries is of high importance in order to promote global value chains. Another important issue for some members is a need for widening of their export basket.

In short, this book aims to present a deep and meticulous analysis of what the Pacific Alliance is so far. Beyond delving into an informed explanation of the process of regional integration, the book tries not only to offer a landscape of untapped opportunities that may potentially contribute to the success of the Pacific Alliance, but also to make serious recommendations in areas that may present substantial challenges for the Pacific Alliance.

Ambassador Antonio Núñez y García-Saúco
President
European Institute of International Studies

THE NEW MODEL OF REGIONAL INTEGRATION FOR EMERGING COUNTRIES IN LATIN AMERICA: THE PACIFIC ALLIANCE

Mario Torres Jarrín

1. Introduction

Throughout the last decades, Latin America has seen the birth of a great many integration projects. Some of them have surged in a regional context, such as ALADI, SELA, Grupo del Río, and, ultimately, CELAC (Community of Latin American and Caribbean States). In other cases, the projects have been developed in a sub-regional context, such as SICA, CARICOM, MERCOSUR, ALBA, and UNASUR. The majority of these projects contemplated the creation of markets based on geographical proximity; that is to say, one of the main arguments justifying the integration was the geographical component and not necessarily a shared political and economic vision, as is the case with the Pacific Alliance.

It was thought that the development of countries involved in these projects would come about through increased commerce of goods and services within a broadened and/or common market. Based on this premise, Latin America had different mechanisms and organisms which promoted, mainly, the ideas of free commerce zones, unionized customs and common markets; and in very few cases, such as the Centro-American and the Andean ones, on the idea of forming a political union of states, one with a supranational character and common institutions. From the 1950s until the present day, Latin American countries have implemented a variety of integration models; the first of these, based on the theories of imports, customs unions and the creation of scale economies through the opening of preferential markets, with the aim of protecting national industries, which consequently viewed the integration process as coming from within. Later came the theory of open regionalism,

encouraging free trade and the elimination of both tariff related and non-tariff related barriers, and with this, a heightened interest in forging connections with other regions of the world–that is to say, creating a sort of integration which would ensure a strengthening at an intra-regional but also at an inter-regional level, while following the current trend of increasing globalization of the economy.

The Pacific Alliance (PA) was created within the frame of these various Latin American integration processes, and is based on the shared political vision of its members. The member states of the Alliance have as fundamental pillars the defense of the democratic political system, macro-economic stability, fiscal responsibility, and the promotion of free trade as a creator of jobs, growth and development. In intra-regional terms, the Alliance seeks to build an area of deep integration, which is defined as an area that includes the free circulation of goods, services, capital and people. In extra-regional terms, it has the objective of becoming a platform for political articulation, as well as for economic and commercial integration, which projects out onto the world, with a special focus on the Asia-Pacific region. This last aim responds to a vision of the future of the world economy, in which it is foreseen that the Asia-Pacific region will be the central axis on which commerce and the world economy turn, and therefore, will become the political center on which the policies which form the world are designed, elaborated and determined, both in political and economic terms. A part of these decisions go through the impact and repercussions that the "global value chains" have on the whole global economy; because of this, the Alliance has as the Asia-Pacific region as its primary focus, as many of the "global value chains" are centralized or developed in this region. If the Pacific Alliance is able to enter and become a part of these "global value chains," not only will it achieve higher rates of economic growth, because it will have introduced its goods and services within those chains, whose products and services are consumed throughout the world; but it will also have become a bloc of integration which will lead, with its model of integration, the development of Latin America, and turn this region into a global actor to be reckoned with on the world stage.

2. A Theoretical Explanation of the Pacific Alliance Integration Model

In order to explain and understand, from a scholarly viewpoint, the process of regional integration undertaken by the member states of the Pacific

Alliance, it is necessary, first of all, to define a set of concepts, such as region, regionalism, regionalization and interregionalism. We can therefore interconnect the theories of regional integration processes with the concrete objectives and actions of the Pacific Alliance.

According to Hettne, from an empirical observation of the various new economic and political processes that are taking place throughout various geographic areas of the world, a region is defined as a group of countries that share, to an extent, a political project.[1] He adds, furthermore, that a region is traditionally defined as a limited number of states that are bound by their geographical proximity and a certain degree of mutual dependence; but he also indicates that, at present, a region can not only be defined as a simple aggregated set of states which decide to begin a process of regional integration. In this regard, a region can be defined as a set of states that seek to transcend the center-state.[2]

Sharing the same view as what was described in the preceding paragraph, and with the same sense of transcendence of the state of its own borders, we find Katzenstein, who tells us that regions are the creation of a new political power whose purpose is to extend the power of states beyond their borders and that, in order to achieve this, they must employ a combination of strategic action and their total power.[3]

For Fawcett, geographical proximity as the principal element which defines a region is not enough. Therefore, he suggests that a simple geographical definition will not do, and asserts that regions must be seen from a broader perspective, with more elements as reference; thus, they are units, or zones, which are based on a group of states or territories whose members share certain common features,[4] such as a political system and/or an economic system.

According to these conceptual definitions, we can say that the Pacific Alliance fits better under Fawcett's definition of a region than under Hettne's, because the process of regional integration starts from a set of common

1. HETTNE, B., INOTAI, A. AND SUNKEL, O.: *Globalism and the New Regionalism.* Palgrave Macmillan, New York, 2002. p. 1.

2. HETTNE, B. and SÖDERBAUM: "Theorising the Rise of Regionness" in BRESLIN, S., HUGHES, C., PHILLIPS, N and ROSAMOND, B.: *New Regionalisms in the Global Political Economy*. Routledge, New York, 2002, p. 37 y 38. See also: SÖDERBAUM, F.: *The Political Economy of Regionalism. The Case of Southern Africa.* Palgrave Macmilan, Hampshire, 2004.

3. KATZENSTEIN, P. J.: *A World of Regions: Asia and Europe in the American Imperium.* Cornell University Press, Ithaca, 2005. p. 21.

4. FAWCETT, L.: *Regionalism from an Historical Perspective.* En FARRELL, M., HETTNE, B., and VAN LANGENHOVE, L. Op. cit. p.24.

elements, such as a political system that defends democracy and the rule of law;[5] and an economic system that promotes the flow of trade in goods and services in order to consolidate a free trade area between the Parties,[6] and in this way, moves towards the free movement of capital and the promotion of investment.[7] Therefore, the actions of the Alliance could not be classified within the regional definitions of Hettne, as the member states of the PA do not seek to transcend the center-state. And it does not fit under Katzenstein's theory, either, since the PA strives to be a new political player whose purpose is to extend the power of the states beyond their own borders, although it does consider becoming a platform for political articulation, as well as for economic and commercial integration, one which projects out onto the world, with a special emphasis on the Asia-Pacific region,[8] by exerting its economic weight.

On the other hand, as mentioned by Hänggi, Roloff and Rüland, regionalism and regionalization are now universal phenomena.[9] However, Söderbaum considers it necessary to distinguish between regionalism and regionalization,[10] because, though they may seem similar, in truth they are not. In many cases, there are processes that are usually framed by the concept of regionalism, when in fact they are processes of regionalization, and vice versa. This confusion is, to our understanding, something recurrent in all Latin American countries, which, in addition, further obfuscates the difference between the concepts of integration and cooperation. Practically the same mix-up occurs academically when, through studying a process of regional integration, an attempt is made to explain it; a fact which is compounded when there is an endeavor to draw a comparison to other processes being carried out in the world. This is further aggravated when a process of inter-regionalism occurs and starts off from the precept that the regions involved in this dialogue are the same –often they are not– for the most part, their differences lie on their degrees of institutionalization and in their skills systems.

In this sense, Söderbaum distinguishes between regionalism and regionalization. The difference is that the former is a generalized phenomenon

5. Article 2. Framework Agreement of Pacific Alliance, Antofagasta, 6 June 2012.

6. Article 3. 2. a. Framework Agreement of Pacific Alliance, Antofagasta, 6 June 2012.

7. Article 3.2. b. Framework Agreement of Pacific Alliance, Antofagasta, 6 June 2012.

8. Article 3.1. c. Framework Agreement of Pacific Alliance, Antofagasta, 6 June 2012.

9. HÄNGGI, H, ROLOFF, R and RÜLAND, J.: *Interregionalism and International Relations,* Routledge, London, 2006, p. 4.

10. SCHULZ, M., SÖDERBAUM, F. and ÖJENDAL, J.: *Regionalization in a Globalizing World. A Comparative Perspective on Forms, Actors and Processes.* Zed Book, London, 2001, p. 5.

throughout the world, and includes a set of ideas, ideologies and identity common to a specific region, whose dynamics develop within a formal framework; that is to say, a project of regional integration whose construction involves the creation of a supranational institution and thus implies a certain degree of transfer of sovereignty through the creation of a system of competences. The second, in contrast, is the result of regionalism and also notes that regionalization may have no need for a specific project, or any desire to create supranational institutions; so the actors can engage in the process in a natural way and without a specific set of convictions.[11]

Therefore, regionalization is considered to be a process that usually begins with a shared commercial and economic interest, which is to say, from an economic logic,[12] and one in which there are different actors, and in which the role played by companies is marked. In the process of development of relations between businesses from various countries, the states in which these companies are located also become promoters who are involved in the process of regionalization by creating policies that facilitate and promote an expanded market, so that the domestic market is broadened into a regional market through the creation of single markets or a common market, thus enabling companies may enjoy a free flow of goods, services and capital with a basis on a legal framework. Therefore, regionalism is an expression of political will whose main actors are states, and whose foundations are not only economic and/or commercial, but also political, social and cultural. The development of regionalism represents the express will of the states at an international level in order to project a set of ideas, values and principles pertaining to a subregion or region, and defend them globally.

For his part, Deblock believes that in international relations, regionalism means all forms of institutionalized cooperation between two or more countries.[13] Therefore, it can be said that regionalism, in addition to the free movement of goods, services and capital, implies the free movement of people.

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11. SÖDERBAUM, F.: *The Political Economy of Regionalism. The Case of Southern Africa.* Palgrave Macmillan, Hampshire, 2004. p.7.

12. SANTANDER, S.: *Le régionalisme sudaméricain, L´Union européenne et les États-Unis,* Institut d´ Etudes Européennes, Bruxelles, 2008.

13. DEBLOCK, C.: *Régionalisme Économique et Mondialisation: Ques nous apprennent les théories?* Cahier de recherche 05-07. Continentalisation. Groupe de recherché sur I´intégration continentale. Centre Études Internationales et Mondialisation, Institutut d`études internationales de Montréal. Université du Québec à Montréal, Octobre 2005.

Gilson, when defining the behavior and interaction of states against regionalism and regionalization, points out that regionalism may be seen as a "top-down" process; that is, a process which is led mainly by the states, which seek to define a regional identity and develop community institutions that help deepen regional integration. On the other hand, regionalization is a process that develops "bottom-up,[14]" which is a process led by private companies and in which participation by state is limited to facilitating, mediating and creating mechanisms to bring about increased trade between companies operating within a region.

In both cases, we can see how there is a change in the way in which international relations develop, as well as how the power of states and their actions in favor of the creation and implementation of economic, trade and development policies is no longer the exclusive jurisdiction of the states. This power is now shared with corporate powers; even more so if we consider that the globalization process has strengthened the power of the latter. Markets no longer only seek to satisfy the needs of local and national demand; now they aim to meet demand at a regional and/or global level.

In this sense, and according to everything that has been described, we can conclude that the process undertaken by the countries of the Pacific Alliance is located between the two theories; we can say that the Pacific Alliance is a process of "institutionalized regionalization" or "flexible regionalism," because it meets the definition of a process of regionalism, except for the part about creating supranational or community institutions, and therefore, also leans toward the concept of regionalization. The idea of not wishing to develop supranational bodies has long been an aspect of regionalization that the member states of the Alliance have tried to avoid, arguing that these institutions generate bureaucracy, rather than efficiency and effectiveness in the process. However, in our view, given the objectives of the Alliance, especially if they want to really project themselves globally, they will, at some moment, be forced re-assess the need for supranational institutions and implement a valid system of skills in order to achieve maximum efficiency and effectiveness in their foreign policy.

Finally, from the point of view of interregionalism, as well as the aforementioned concepts and theories, it is born, by reference, from the regional integration process in Europe; as such, interregionalism lies within the scope of the foreign policy actions of the European Union. Such action is led from

14. GILSON, J.: *Asia meets Europe: Inter-Regionalism and the Asia-Europe Meeting,* Edward Elgar Publishing Limited, Glos, 2002. p. 3.

community institutions, considering that it is in this way in which a greater influence is achieved in negotiations, as well as a better representation when dealing with third parties. Interregionalism is usually defined as the political dialogue that is established between two regions of the world. In the case of the Alliance, we can cite two examples of interregionalism; the first, the political dialogue developed with ASEAN (Association of Southeast Asian Nations),[15] which was the first meeting between the two regions held within the framework of the United Nations General Assembly. The meeting was held at a ministerial level on September 26, 2014, in New York; and it was agreed in it to strengthen the links between the two regions by creating a working agenda. On May 25, 2015, the Ambassadors and Representatives of the PA and the Committee of Permanent Representatives of ASEAN met in Jakarta to define the topics of that agenda, among of which were: energy, minerals, trade facilitation, innovation, logistics, infrastructure and SMEs.[16] The second dialogue was established with the APEC (Asia-Pacific Economic Cooperation Forum), and was held on the occasion of the XXIII Meeting of APEC, on November 18, 2015. This first meeting between the two regions had as a main objective to define the opportunities for complementarity and synergies within the respective agendas, and at the same time, to discuss the projection of the Alliance in the Asia-Pacific region.

3. Genesis of the Alliance: From the Pacific Rim-Latin America Forum to the Pacific Alliance

The birth of the Pacific Alliance is usually dated through reference to the Lima Declaration, which was signed on April 28, 2011. This declaration was passed as part of the celebration of the First Presidential Summit of the Pacific Alliance, to which the presidents of Chile, Colombia, Mexico and Peru attended, and who decided to establish an alliance whose objective would gradually move towards the free movement of goods, services, capital and persons among the undersigned nations. However, it is rarely mentioned that its actual

15. ASEAN is comprised of Malaysia, Indonesia, Brunei, Vietnam, Cambodia, Laos, Myanmar, Singapore, Thailand and the Philippines. These are observer states of the Pacific Alliance: Singapore, Indonesia and Thailand.

16. Pacific Alliance identifies Areas for Cooperation with ASEAN. Available on the website of the Pacific Alliance, at https://alianzapacifico.net/en/pacific-alliance-identifies-areas-for-cooperation-with-asean/

beginning goes back to a previous project, the "Forum of the Latin American Pacific Rim," which aimed to unite all Latin American countries bordering the Pacific Ocean in a single instance. The year 2006 would be key in the history of the Pacific Alliance, because during this year, a number of events leading to the genesis of the Alliance occurred. In 2006, the Peruvian government decided to promote an initiative that sought to turn the focus towards Asia, and at that time considered that it must, from the so-called "Andean Community," promote the creation of a broad area of free trade by convening every country bordering the American Pacific Basin, from Mexico to Chile. Shortly thereafter, Peru and Colombia signed free trade agreements with the United States, taking as legal reference the Andean Community's Decision 598 on Trade Relations with Third Countries, dated on July 11, 2004; this decision states that "the Member Countries may negotiate trade agreements with third countries, preferably in a community or joint setting, and exceptionally in an individual manner."[17] And it adds that "were it not possible, for some reason, to conduct community negotiations, Member Countries will negotiate bilaterally with third countries."[18]

These events generated an internal crisis within the Andean Community, which ended with the departure of Venezuela and dissentions by Ecuador and Bolivia in relation to their Andean partners, Colombia and Peru. That same year, in 2006, Peru also began negotiations to reach a free trade agreement with China, on the basis of the enormous potential afforded by the Asian giant, as well as the whole of the Asia-Pacific region. To add to all this, the Peruvian government considered the impact the Trans-Pacific Partnership (TPP) and the Transatlantic Partnership for Trade and Investment (TTIP) could have on the country, and on the whole Latin American economy; their analysis was largely based on the initial premise that the latter two initiatives are intended to set international standards on which all trade relations of the world shall be directed, while setting out to become the two largest economic areas in the world.[19]

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17. Article 1. Decision 598 Commercial Relations with Third Countries. Meeting of the Andean Council of Foreign Affairs Ministers, in Amplified Form with Representatives Before the Andean Community Commission, July 11, 2004, Quito, Ecuador. It may be seen on the website of the Community General Secretariat, Andean Legislation.

18. Article 2. Decision 598, Op.cit.

19. ESTEVADEORDAL, A.: The Pacific Alliance and Megaregional Agreements: Opportunities for a More Profound Investigation. *(La Alianza del Pacífico y los acuerdos megarregionales: oportunidades para una integración más profunda*), Bridges Network. News analysis on commerce and sustainable deveelopment. Vol. 15 N 6, September 2014.

At this juncture, Peru insisted on trying to strengthen the Andean Community, and urged that Chile return to the CAN; on one hand, to reinforce the CAN as Venezuela left it, and on the other, from the same shared vision with this country on free trade and open markets, as well as a shared membership in APEC with Chile–though Chile would not fully return as a Member State of the CAN; but only as an Associate Member. Given these facts, Peru abandoned the idea of convening a meeting by using the CAN as a platform to summon it. Instead, it did it unilaterally, through its president, Alan García Pérez, and his Foreign Minister, José García Belaunde, who both made efforts to assemble a meeting which brought together all the American countries with coasts bordering the Pacific Ocean.[20] With this goal on the agenda, on January 29 and 30, 2007, a meeting was held in Santiago de Cali, with the participation of trade ministers from the following countries: Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Peru. The result of this initiative was the "Forum on the Initiative of the Latin American Pacific Basin," which later became known as the "Latin American Pacific Rim Forum."[21] This initiative sought to implement joint actions on the foreign policy stage by generating synergies in the economic, trade and investment areas, with the main objective being to strengthen relations with countries of the Asia-Pacific region. However, economics were not the only priority, as possible scientific and technical cooperation were also considered, with the ambition to eventually develop goods and services with added value, which is a sector in which Latin America is always seeking growth. The development of mechanisms to promote scientific and technical cooperation in the framework of the Forum of the Latin American Pacific Rim will provide a conceptual basis for a later development of an academic exchange program within the framework of the future Pacific Alliance, if it is taken into consideration that it is only by betting on education and research will added-value products be achieved.

The IV Meeting of the Forum of the Latin American Pacific Basin, held in Santiago, Chile, from October 1-3, 2008, reached an agreement for the General Guidelines for the Forum of the Latin American Pacific Basin, which

20. NOVAK, F. y NAMIHAS, S.: Pacific Alliance: Situation, Perspectives and Proposals for its Consolidation *(Alianza del Pacífico: Situación, perspectivas y propuestas para su consolidación.)* Instituto de Estudios Internacionales de la Pontificia Universidad Católica del Perú and Konrad Adenauer Foundation, Lima, Peru, 2015, p. 24.

21. GARCÍA BELAUNDE, J.: Pacific Alliance: Where Are We Going? (*Alianza del Pacífico ¿Hacia dónde vamos?*), Internacional Agenda (*Agenda Internacional*), Year XX, N31, Lima, Peru, 2013.

defined the meeting of foreign affairs and trade ministers as the highest political organ; at the same time, an executive body was established, as well as the meeting of Senior Officials; and finally, a pro-tempore secretariat, on rotating and annual basis,[22] was considered. But the differences between countries with regard to the vision of regional integration based on opening markets and promoting free trade were among the factors that prevented the progress of the initiative. The political views of Chile, Colombia, Mexico and Peru, which favored greater economic openness and free trade, contrasted with the views of Ecuador and Nicaragua,[23] which were not in accord with the aforementioned policies. All of this, added to the reality of the low level of trade interdependence among member countries involved in the process,[24] meant that there was no great interest by the various parties to bet in favor of such an initiative.

Faced with a context that was so averse to the continued development of the Forum, on October 14, 2010, the President of Peru, Alan García, sent letters to the presidents of Chile, Colombia, Ecuador and Panama, proposing the idea of creating an "area of deep integration" that contemplated the liberalization of trade of goods, services, capital as well as the free movement of persons, in addition to forming a common economic platform to project toward Asia-Pacific and the world.[25] The governments of Chile and Colombia responded positively to this letter. Later on, the same invitation was extended to Mexico, which immediately accepted to participate in the regional integration project.

The First Presidential Summit of the Pacific Alliance was held on April 28, 2011; present at the inauguration were the President of Chile, Sebastián Piñera, the President of Colombia, Juan Manuel Santos, President of Mexico, Felipe Calderón, and the host and promoter of the project, the President of Peru, Alan García. This meeting, officially categorized as a summit, was intended to demonstrate the political will of these four countries to effectively

22. Santiago de Chile Declaration, IV Forum of the Latin American Pacific Arc, Santiago de Chile, October 3, 2008.

23. NOVAK, F. y NAMIHAS, S.: Pacific Alliance: Situation, Perspectives and Proposals for its Consolidation *(Alianza del Pacífico: Situación, perspectivas y propuestas para su consolidación.)* Instituto de Estudios Internacionales de la Pontificia Universidad Católica del Perú and Konrad Adenauer Foundation, Lima, Peru, 2015, p. 31-32.

24. BRICEÑO, J.: The Latin American Pacific Arc Initiative. A New Actor on the Regional Integration Scene. (*La Iniciativa del Arco del Pacífico Latinoamericano: Un nuevo actor en el escenario de la integración regional*), Nueva Sociedad, N 228, June-August, Buenos Aires, Argentina, 2010.

25. CASTRO, L.: The Pacific Alliance and the Foreign Policy of Peru. (*La Alianza del Pacífico y la política exterior del Perú.*) Política Internacional, N 107, January-March, Lima, Peru, 2013.

implement the Pacific Alliance project. Hence, the meeting was not at the level of ministerial rank, but rather at the level of heads of state and government–which is to say, the highest possible political body. This action, in turn, demonstrated the political commitment of these countries for the project; but furthermore, it represented the birth of a new regional process which mirrored, in many ways, previous international processes of integration whose highest political authorities were also present at the level of presidential summits.

The Peru Summit resulted in the Lima Declaration, which established the Pacific Alliance as an area of deep integration within the Latin American Pacific Basin.[26] Later, the presidents instructed their foreign and trade ministers to develop a framework agreement which sought validation with all existing free trade agreements between the member states of the PA. Thus a High Level Group was formed, composed by the deputy ministers of foreign affairs and trade, and four technical groups were established to work in the following areas:

1. Movement of people
2. Trade and integration
3. Service and capital
4. Cooperation and dispute resolution mechanisms

The first group was in charge of Mexico, the second handled Chile, the third Colombia, and the fourth Peru.

This new integration process led countries to develop a new form of regional integration which not only considered economy and trade, but which also included, from the start, a comprehensive agenda that took into account cooperation in various areas, such as physical integration, connectivity, education, environment and sustainable development. In addition, it introduced the idea of joint action in the fields of trade promotion, consular assistance and the joint participation of the public and private sector.

Since 2011 to the present day, there have been ten presidential summits. The last of these was the X Summit of the Alliance, which took place in the city of Paracas, Peru, between days of July 1-3 of 2015. The same month, on July 20, the Framework Agreement of the Pacific Alliance came into effect.

26. Lima Declaration, I Presidential Summit of the Pacific Alliance, April 28, 2011.

4. Potentials and Challenges of the Pacific Alliance

Among the strengths of the Alliance is its economic and commercial potential. According to data and reports by major international organizations like the International Monetary Fund (IMF), the Inter-American Development Bank (IDB), the CAF-Development Bank for Latin America (CAF), and the Economic Commission for Latin America and the Caribbean (ECLAC); the Alliance constitutes 50% of trade in the entire region of Latin America; brings together 37% of the GDP of the region; has a GDP growth rate of 4%; and an inflation rate of 3.57%.[27] At the same, time it represents a market with a population of 214 million people, who have an average per capita GDP of $16,500 USD.[28] That is to say, more than the large regional economies such as Argentina (with a per capita GDP of $12,500 USD) and Brazil (with a per capita GDP of $11,384 USD) or the extra-regional emerging economies such as China (per capita GDP of $7,590 USD), India (per capita GDP of $1,581 USD), Indonesia (per capita GDP of $3,490) and Malaysia (GDP per capita of $11,307).[29] On the other hand, according to the World Bank assessment "Doing Business 2015" the countries of the Alliance are ranked among the top four countries in Latin America the offer the best conditions for doing business; Colombia ranks first (and 34th worldwide), followed by Peru (ranked 35th globally), Mexico (39th globally) and Chile (41st worldwide).[30] Finally, according to the International Monetary Fund, the four countries have an average inflation rate of 3% and together account for 37% Latin America's GDP[31]– all of these figures make the Pacific Alliance the eighth world economy, and the eighth most powerful exporter.[32] This panorama means these countries are effectively the main emerging economies of Latin America.

27. As part of the annual meetings of the Board of Governors of the World Bank Group and the International Monetary Fund, from 9 to 11 October 2015 in the city of Lima, the director of the IMF, Christine Lagarde, highlighted the potential of countries of the Pacific Alliance, mentioning that "the reforms that have been made in these countries are positioning them in the category of regional economic stars." Diario el País, Bogota, October 11, 2015. For more data on the Pacific Alliance, please see: ECLAC (Economic Commission for Latin America and the Caribbean): The Pacific Alliance and MERCOSUR. Towards Convergence in Diversity, Santiago de Chile, November 2014.

28. Statistical data of the World Bank, 2014-2015.

29. World Bank, GDP per capita by country 2015.

30. World Bank: Doing Business Ranking 2015.

31. International Monetary Fund, statistical facts obtained from the 2014-2015 database.

32. The Pacific Alliance: ABCs of the Pacific Alliance (*Alianza del Pacífico: Abecé Alianza del Pacífico*) http://alianzapacifico.net

This new integration process has emphasized that it seeks to achieve a deep integration, and thus create a new concept, one which is based on pragmatism and realism. The special emphasis in indicating these two terms is an attempt to point out that the Alliance does not wish to fall into the rhetoric and grand objectives held by other existing integration processes in the region, all of which have aspired to become processes of political or economic union; a goal which, despite being decades old, they have for the most part not succeeded in achieving. Cases such as ALADI, SELA, the Andean Community, MERCOSUR, UNASUR, to mention only some; that, far from representing all the interests of their member states, have been forums serving mostly to highlight the differences between them, rather than having a convergence of interests prevail within the aforementioned integration schemes.

Critics of the Pacific Alliance, mainly Latin American countries advocating a more closed, protectionist economic policy, who are critical of foreign investment, consider that this process is only the sum of macroeconomic figures, but that they do not have a solid base at the microeconomic level; and, failing that, it is thought that it is not a process of regional integration, but merely an area of free trade.

The shared vision of the four countries of the Alliance allows for a clear difference between the countries that want to continue betting on a protectionist model and a closed economic model, one in which the State is the main driver and promoter of the economy; in contrast to the other countries, which seek to have a more open economy and bet on a non-protectionist model, one which is not isolated from the global stage, but rather opts for insertion into the global economy, seeking to insert and integrate their businesses into the global value chains and become more competitive internationally. At the same time, these countries look to attract more foreign investment. Therefore, member states of the Alliance are trying to partner and compete with the region where the hub of the world economy is supposedly located: the Asia-Pacific region.

Now, to reach these goals, it will first be necessary to overcome certain challenges, such as surmounting unresolved issues at an intra-alliance level, for example, and in commercial terms, to achieve a liberalization of 100%, instead of being content with having the current level of 92%, given that it has been stipulated that the remaining 8% will, in the current schedule, and according to the so-called "sensitive" products, be done away with in 5, 10 or 15 years. The globalized world shows that everything can change in 6 months, not to mention a year; therefore, thinking that the outcome will occur in between 5 and 15 years, sends the wrong signal internationally, to nations and

to investors–something that is not in tune to what aspiring Alliance members wish to present, as the emerging economies of the region that are committed to leading a region of free trade without barriers of any kind (tariff and non-tariff). The latter, non-tariff barriers, are often the culprit in preventing a greater flow of trade, even when there is an absence of tariff barriers.

Another challenge for the Alliance is to strengthen its institutions. While it is true that its governments have always emphasized that they do not want to create institutions and are not intended to have community or supranational institutions, the Alliance's agenda and its foreign policy say the opposite, as it is more than necessary to have institutes that are working permanently; that is, a team representing the Alliance that will facilitate the foreign representation that the Alliance aspires to. To do so may be a better articulation of foreign policy, such as trade promotion, and give it greater heft in negotiations with third parties. The system of pro tempore secretaries is a dynamic and flexible system, but it is subject to the priorities that the country holding the pro-tempore presidency wants to implement or prioritize –something that can be positive if they coincide with the priorities of its peers, but if it is not the case, it is a risk that could well cause problems to the process in the future.

Foreign representation has always been one of the problems of regional integration processes in Latin America. In this sense, the relationship with the Association Southeast Asian Nations (ASEAN) is vitally important for the Alliance when trying to insert itself into global value chains countries in the Asia-Pacific; this relationship opens up a new area of cooperation between the two mechanisms of integration,[33] but in its inter-relationship, the Alliance has no equivalent institutions that have the same degree of institutionalization and competence when sitting down to negotiate with the institutions of the ASEAN. While it is true that the Pacific Alliance has an organizational structure of operation and coordination, it does not have a permanent body that has own powers of representation at the level of Alliance, an issue that should resolved as soon as possible by the Alliance countries if they wish to meet their goal of achieving a positive foreign projection.

33. Paracas Declaration. X Presidential Summit of the Pacific Alliance, Paracas, Peru, July 3, 2015.

5. Foreign Policy and External Action of the Pacific Alliance

5.1. Shared Embassies

In relation to the previous point, we can say that the idea of having "shared embassies" will undoubtedly contribute to a greater visibility for the Alliance in the international scene. A joint foreign policy will undoubtedly give it greater weight in negotiations with third parties, while allowing for the provision of better supplies for export and presenting themselves as a single market in order to attract investments and promote tourism; another novel aspect of the Alliance has been the inclusion of the services sector in the integration process.

It could be said that with the birth of the Alliance also marked the beginning of the end of the Andean Community of Nations; because if two of its four members, Colombia and Peru, are reorienting their integration priorities in the Alliance, and given the differences in vision regarding the same integration with their other two partners, Ecuador and Bolivia, one could plausibly say that the days of the CAN are numbered. However, there are elements that allow one to think some of the policies from the history of Andean integration can be rescued within the framework of the Alliance; and if not that, one could consider that part of the Andean integration process could be reflected in the foreign policy of the PA. Specifically, the regulatory archive of the Common Foreign Policy may provide elements that contribute to the articulation of the foreign policy of the Alliance. It is true that these Guidelines for Foreign Policy under the CAN never got the chance to be put into effect, but they were reflected in several regional norms that could serve as legal references, including: Resolution 528, "Criteria and Guidelines for the Formulation and Implementation of Common Foreign Policy;" Decision 499, "Update to Directive No. 1 on the Formulation and Implementation of Common Foreign Policy;" Decision 475, "Directive No. 1 on Common Foreign Policy;" and Decision 458, "Guidelines of the Common Foreign Policy." For example, in the last decision, three types of "Modalities of Action" were contemplated:

a) Adopting common positions, joint actions and unique spokespeople, including the organization of voting and nominations;
b) Regular coordination between the Diplomatic Missions of Member Countries with third countries and international organizations; and

c) Any eventual joint diplomatic representations.[34]

As is evident, many of these actions are those being considered by the Alliance in order to carry out its foreign policy.

The invitation extended to Mexico to form a part of the PA is often seen as a challenge to Brazil, both in terms of regional leadership and in terms of international visibility. It is believed that the participation of Mexico was to serve as a geopolitical counterweight against Brazil. However, it was initially dating back to the CAN where it was sought to boost the visibility of the Pacific Rim; it should also be remembered that Mexico was an Observer State of the CAN, a status that is even regulated in Decision 741[35] of the 2010 Andean Community. Therefore, the invitation to Mexico was only a natural progression of a dialogue that had already been established by Peru and Colombia within the framework of the Andean Community.

No doubt the idea of having joint diplomatic delegations and trade missions will contribute to creating a greater visibility for the Alliance, especially in regions where the member countries are little known; and in the regions where they are already known, it will be necessary to be able to make joint offers of exports in order to insure clients which, on their own, the states could not supply for.

Currently, member states of the Alliance have several agreements to share embassies and delegations in third countries, such as is the case with Ghana (Chile, Colombia, Mexico and Peru); Vietnam (Colombia and Peru); Morocco (Chile and Colombia); Algeria (Chile and Colombia); Azerbaijan (Chile and Colombia); and a diplomatic mission to the Organization for Economic Co-operation and Development (Chile and Colombia). It is also expected that Mexico and Colombia will open a joint embassy in Singapore.[36]

34. Decision 458, Guidelines for a Common Foreign Policy, Andean Council for Foreign Affairs Ministers, May 25, 1999, Cartagena de Indias. See General Secretariat, Andean Normative Guidelines.

35. Decision 741, Observers of the Andean Community, Twenty Second Meeting of the Andean Council of Foreign Affairs Ministers of the Andean Community, Lima, Peru, July 22, 2010. General Secretariat of the Andean Community.

36. VILLARREAL, A.: The Pacific Alliance: A Trade Integration Initiative in Latin America, Congressional Research Service, CRS Report Prepared for Members and Committees of Congress, October 2, 2014. Read more at: Congressional Research Service, United States Congress: https://www.fas.org/sgp/crs/row/R43748.pdf

5.2. The Role of Observer States

Among the other challenges that the Alliance faces is the development of its intra-regional trade, which currently barely reaches 4%. To develop trade at an intra-regional level requires infrastructure and interconnectivity between the coast and the interior of the country; in each of the members of the PA and between each other, this is a pending, and pressing, issue to be resolved. The aspiration is to increase trade with the Asia-Pacific region, and in this way become a crucial link between Latin American countries of both the Atlantic and Pacific coasts. Moreover, they wish to realize the possible convergence between MERCOSUR and the Pacific Alliance, and thus become an avowed catalyst for integration in Latin America.[37]

Now, before the possible compatibility of visions on regional integration is properly assessed, it must be stated that there is a big difference in the design and the possible integration of the two schemes –the Alliance promotes free trade, while MERCOSUR has tended more towards trade protectionism. Without a clear view of this crucial distinction, the development of a common or shared agenda might hinder the development of the Alliance rather than being a positive factor in it. It remains to be seen if both blocs manage to reach an agreement.

Alliance ports have no logistical capacity to increase trade flows, and each country needs greater connectivity between ports and airports. At this point, the role of observer countries could play an important role, because they could help realize joint projects that contribute to technology transfer with the countries of the Alliance, as well as attracting new capital. There is no doubt that both the embassies of each of the Member States of the Alliance as embassies and shared representations hold an important role in making it possible to identify and establish contacts with the observer countries that are interested in working together in the aforementioned areas.

37. CEPAL: The Pacific Alliance and MERCOSUR. Towards Convergence in Diversity. Santiago de Chile, 2014. For more information, please read:
http://www.cepal.org/es/publicaciones/37304-la-alianza-del-pacifico-y-el-mercosur-hacia-la-convergencia-en-la-diversidad

Currently, the Pacific Alliance has 42 observers,[38] and it is expected that they will be able to participate in presidential and ministerial meetings.[39] To achieve observer status, it is necessary that the country in question sign free trade agreements with at least half of the participating parties; additionally, any Observer State may, at any time, apply to be a candidate for full membership.[40]

The strength of the Alliance lies in the fact that it is a process of regional integration whose founders possess some of the most open world economies, with growth rates and stable development, and have an increasing population rate with ever-higher purchasing power if compared to its regional neighbors. This fact has resulted in the emergence of a growing middle class that is demanding increasingly more goods and services.

6. The Nordic Countries and the Pacific Alliance

At the X Presidential Summit of the Pacific Alliance, held in the city of Paracas, Peru, on July 3, 2015, ten new observer states were accepted, including: Austria, Denmark, Georgia, Greece, Haiti, Hungary, Indonesia, Poland, Sweden and Thailand. The incorporation of Denmark and Sweden was added to Finland, already an Observer State of the Alliance, so that only Norway and Iceland remain to be added. Although Norway has already requested Peru, as Pro Tempore Secretariat of the Alliance (until June 2016) to become an Observer State, this proposal was only presented until October 2015.[41]

The incorporation of Denmark and Sweden as Observer States of the Alliance coincides with the fact that the four member countries of the Pacific Alliance enjoy a close relationship with the European Union. In the case of Sweden, a press release issued by the Ministry of Foreign Affairs of Sweden

38. Observer States of the Pacific Alliance, January 2016: China, India, Tailandia, Indonesia, Singapur, Australia, New Zealand, Japan, South Korea, United States, Canada, Guatemala, Haiti, Honduras, Dominican Republic, Trinidad and Tobago, El Salvador, Costa Rica, Paraguay, Uruguay, Panama, Ecuador, the Netherlands, United Kingdom, Portugal, Austria, Turkey, France, Spain, Greece, Finland, Belguim, Sweden, Denmark, Germany, Poland, Switzerland, Italy, Georgia, Morocco and Israel.

39. Section 5. Guidelines on the Participation of Member States in the Pacific Alliance.

40. Secrtion 6. Guidelines on the Participation of Member States in the Pacific Alliance.

41. Peruvian News Agency: Norway Asks Peru to be an Observer State of the Pacific Alliance. (*Agencia Peruana de Noticias Noruega pide a Perú ser observador en Alianza del Pacífico*), Lima, Peru, October 31, 2015. More information here: http://www.andina.com.pe/agencia/noticia-noruega-pide-a-peru-ser-observador-alianza-del-pacifico-582535.aspx

on February 23, 2015, emphasized that the request for membership as an Observer State was a response to the fact that the countries the Pacific Alliance are the closest in Latin America to Sweden on issues such as free trade, democracy, freedom and human rights. The press release added that the EU has existing association and free trade agreements with all members of the Alliance, which is considered by all parties to be a positive step towards regional integration in Latin America.

Indeed, the EU has an Association Agreement with Mexico, which is known as a "Global Agreement" since it includes three types of action: economic partnership; coordination and political dialogue; and a cooperation agreement. Mexico was the first Latin American country to sign an association agreement with the EU, in 1997, and has it has since only strengthened its relations with the bloc; to the point that, in 2009, the EU designated it as a "Strategic Partner" whose objectives were to improve cooperation and coordination between the EU and Mexico at a multilateral level on global issues, and to seek to give new encouragement to initiatives and relations at a bilateral level. This association agreement made Mexico one of the ten strategic partners[42] that the European Union has to help it implement its common foreign and security policy, as well as to execute its global foreign policy.

In the case of Chile, relations with the European Union are close and date to the beginning of the process of European integration, during the sixties. In 1964, the European Communities opened a representative office for Latin America in Santiago, Chile; then, with the merger of executives of the European Communities, in 1967, the Santiago office became the Office of the European Commission for Latin America.[43] The legal framework of political and economic relations between the EU and Chile are framed by the Association Agreement (2002)[44], by which they agreed to work together on issues of both of bilateral interest (EU-Chile) and at an international level, that is to say, to agree on joint positions in multilateral forums and organizations.

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42. The ten member partners of the European Union include: Brazil, Canada, China, India, Japan, Mexico, Russia, South Africa, South Korea and the United States.

43. FOREIGN AFFAIRS MINISTRY OF CHILE: Chilean Mission before the European Mission. Bilateral Relation Between Chile-European Union. http://chileabroad.gov.cl/ue/relacion-bilateral/relacion-bilateral-chile-union-europea/ Last version: 10-01-15.

44. EUROPEAN EXTERNAL ACTION SERVICE: Agreement Through Which an Association Between the European Community and the Republic of Chile is Established.
http://eeas.europa.eu/delegations/chile/documents/eu_chile/eu-chile_assoc_agree_es.pdf Last version: 10-01-15.

In the case of Colombia and Peru, relations with the EU were framed at an inter-regional level, between the European Union and the Andean Community. The relations between the parties began in 1993; in 1996 the Rome Declaration is issued, which defined the relations between the two regions through the establishment of political dialogue. In 2003 the dialogue was broadened with the signing the Agreement on Political Dialogue and Cooperation Agreement between the European Union and the Andean Community, which served as a legal instrument to deepen relations between the two regions, covering topics such as conflict prevention, good governance, migration, environment, climate change, sustainable development, money laundering, combating organized crime and terrorism. It excluded, however, the commercial field. Subsequently, in recent years, Peru, like Colombia, wanted to define the Association Agreement being negotiated between the EU-CAN to an inter-regional level, but the withdrawal from the negotiations, first by Venezuela, then by Ecuador and Bolivia, made only a minimal agreement possible, resulting in the Multiparty Trade Agreement between EU-Colombia and Peru, which was signed in 2012, and entered into force in 2013.

Denmark, Norway and Sweden can contribute their experience in maritime transport issues and in terms of infrastructure and logistics management ports, sectors where these countries have an important source of knowledge for the Pacific Alliance. The development of logistics platforms in each of the member countries of the Alliance would reduce associated costs to freight costs that currently are high, the lack of interconnection (highway infrastructure, ports, rail and rivers) there between inland areas of countries and their respective coasts, are axes on which the cargo handling to markets in the Asia-Pacific region will work. In this regard, the Inter-American Development Bank, includes a study by Andres Escobar entitled "Specialized Logistics Infrastructure: Models That Are Applicable to Colombia Highlights and Proposals for Institutional Arrangement," on the same topic points to the Nordic experience as a model to consider. Escobar indicates that most existing platforms in the Nordic countries have been initiatives by regional or local governments, and in other cases, the private sector. It notes that many of these platforms have received financial support from the European Union. Danish collaboration between regional governments and southern Norway and western Sweden have allowed for joint projects with a shared vision that has led to the creation and strengthening of a network of logistics centers in the Nordic corridor through the Jutland Peninsula.[45]

45. ESCOBAR, A.: Specialized Logistical Infrastructure: Administration Models Applicable to Colombia, Situation and Institutional Arrangement Proposal. (*Infraestructura logística especializada:*

In 2014 a document published by the World Economic Forum, in collaboration with the Inter-American Development Bank and Bain & Company, entitled "Enabling Trade: Enabling Trade in the Pacific Alliance," said that 39% of companies indicate that the main barrier to trade the lack of infrastructure in the countries that are part of the Pacific Alliance.[46] According to data from the Inter-American Development Bank, nowadays, logistics costs represent an average between 18% and 35% of the GDP of Latin America, compared to 9% of OECD countries; and the average investment in infrastructure is 2% of GDP. Likewise, it is estimated that if countries were to increase their infrastructure investment to 6%, this would translate to a rate of GDP growth between 2% and 3%, and would affect the rate of economic growth of the whole region around 4%.[47]

Thus, the challenges of the Alliance should not be limited only to reducing to zero all of the tariffs, it should also eliminate non-tariff barriers and at the same time drastically increase investment in infrastructure. What Joaquim Tres calls the "software" and "hardware" of the Alliance,[48] that is, combining and harmonizing the rules included in the agreements and protocols of the Alliance related to tariffs (software) and to related issues of infrastructure and bureaucratic processes.

From the point of view of the Nordic countries, the vision of the Pacific Alliance is positive, as it represents a realistic process of regional integration, whose pragmatism has specific goals and clear rules, an aspect upon which the Alliance should capitalize, though without falling into the great aspiration of wanting to become a political union of states. The latter has been a cherished dream by Latin American countries, one that has been reflected in the multiple processes created to date since their births as independent republics, but which, until now, is a goal that has remained unrealized by virtue of the

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Modelos de gestión aplicables a Colombia, situación y propuesta de arreglo institucional). Interamerican Development Bank, Final version document, September 2012, p.13. May be seen here: http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=37243543 Last revision: December 26, 2015.

46. WORLD ECONOMIC FORUM: Enabling Trade: Enabling Trade in the Pacific Alliance, Geneva, January, 2014. p. 9.

47. Conference by Alberto Moreno, President of Inter-American Development Bank in the International Economic Forum Latin America and the Caribbean 2014. "Beyond the golden decade? Logistics and Infrastructure, Pillars of Regional Integration and Global Trade Opportunities," organized by the Organisation for Economic Co-operation and Development (OECD) and the Inter-American Development Bank (IDB), held in Paris, June 30, 2014.

48. Conference by Joaquin Tres, Representative of the Inter-American Development Bank, during the Panel: Trade Integration and the Pacific Alliance, organized by Americas Society/Council of the Americas, Washington, March 11, 2015.

nations' refusal to restrict their defense of their respective national sovereignties, thus sacrificing, in the process, the possibility of building community bodies with systems of supranational powers. In this sense, the pragmatism of the Alliance represents realistic objectives.

7. Conclusions

The Pacific Alliance represents a new model of regional integration that seeks to revive the concept with a realistic vision of the globalized world, where trade protectionism has no place and is contrary to the process of integration of economies into the global economy. The strategic vision of the Alliance of looking towards the Asia-Pacific region and towards insertion of their economies into the global value chains, through the creation of productive chains at the level an Alliance, and then projecting them and uniting them with the Asian production chains, it is a strategically intelligent action and a politically savvy response from the member countries of the Alliance. The potential of these lies in the fact of their being the prominent emerging economies of Latin America, their political stability and their defense of democracy as the rule of law; all of which are important factors to attract investment and new partners in order to increase their global trade.

If members of the Alliance are able to promote their intra-regional trade and develop joint production chains and project them outwards, the benefit will be that they diversify their markets, expand exports with value-added products, and can thus manage to reduce their dependence on raw materials.

It is necessary that the Alliance enter a new stage in which it can come into direct dialogue in the development of joint projects with each of its Observer States, because through this it will be able achieve many of its most pressing needs, such as infrastructure development and logistics management of its ports and airports, and a resolution of existing connectivity problems. The Alliance may represent the hub that Latin America so urgently needs to position itself, once and for all, as a Global Actor in the world economy. This action will strengthen the image and expectations we have of the Alliance at an international level, in a pragmatic process based on realistic goals and specific targets.

On the other hand, the Alliance should develop its institutions, creating permanent bodies, which would help to achieve greater efficiency and effectiveness in the adoption and implementation of decisions, while at the same

time providing representation which, for now, is only carried out at the level the main bodies, such as the Council of Ministers and the Pro Tempore Presidency. This could group, for example, the following functions that are now currently distributed throughout various organs of the Alliance:

- "To periodically evaluate results achieved in the implementation of decisions taken in accordance with section a."[49] That is to say, adopting decisions from presidential statements.
- "Coordination of meetings of the Council of Ministers and the High Level Group of the Pacific Alliance."[50]
- "Representing the Pacific Alliance in matters and acts of common interest, on behalf of the Parties; and exercising other powers which are expressly conferred by the Council of Ministers."[51]

All these functions can be carried out more effectively if there is a permanent body, with the characteristics of a General Secretary, a Standing Committee or a Permanent Executive Directorate; this would provide greater representation in negotiations with third parties. Even more so, if one thinks that ASEAN will do the same through its General Secretariat, as will APEC.

Consequently, and not of lesser importance, this instance would give more weight to the Pacific Alliance in the process of negotiations of mega-regional agreements such as the Trans-Pacific Partnership (TPP) and the transatlantic trade and investment partnership (TTIP), since if such agreements are implemented, they will be the largest legal frameworks on which global trade will hinge. In this regard, the agreements which each of the members of the Alliance hold, both the United States and with the European Union, will result beneficial when articulated in both mega-regional agreements. The strategic influence that the Alliance can exert spans three continents: America, Europe and Asia. For George, the Alliance represents a key trading partner for the XXI century for the United States; to Europe, with its current anemic growth, the Pumas of the Pacific (as he calls the four countries of the Alliance) offer economic opportunities; and to Asia, it provides a secure form of access to resources and market expansion.[52] Should it achieve all of these goals, the

49. Article 4. Council of Ministers, Section C. Framework Agreement of the Pacific Alliance, Paracas, June 6, 2012.

50. Article 7. Pro Tempore Presidency, Section B. Framework Agreement of the Pacific Alliance.

51. Article 7. Pro Tempore Presidency, Section B. Framework Agreement of the Pacific Alliance.

52. GEORGE, S.: The Pumas of the Pacific: An Emerging Model for Emerging Markets, New York, 2015, pp. 8-9.

Alliance would become a reference model of integration for Latin America, while at the same time making this region a true Global Actor.

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THE PACIFIC ALLIANCE: TRADE, INVESTMENT AND STRATEGIC CHALLENGES

Alicia Bárcena

Introduction

In the three years since its formal creation, in June 2012, the Pacific Alliance (PA) has attracted a great deal of attention, both in Latin America and other regions. This chapter has a double purpose. On the one hand, to provide an overview of trade and investment links among PA members, and on the other, to discuss some of the main strategic challenges the PA faces going forward. Specifically, two interrelated challenges are addressed in some detail. Firstly, how the PA can contribute to deepening regional economic integration within Latin America and the Caribbean as a whole. Secondly, it will delve into how it can make progress on its stated goal of becoming a platform linking Latin America and Asia-Pacific.

The chapter is organized as follows: Section 1 examines trade in goods and services and foreign direct investment (FDI) flows among PA members; Section 2 discusses the possible role of the PA in strengthening the architecture of regional economic integration within Latin America and the Caribbean. In this regard, emphasis is placed on the importance of defining and implementing a convergence agenda between the PA and the region's largest economic integration mechanism, the Common Market of the South (MERCOSUR); Section 3 addresses the PA's prospects as a vehicle to reinforce economic relations between Latin America and Asia-Pacific; and Section 4 concludes.

1. Trade and Investment Flows within the Pacific Alliance

1.1. Trade in Goods

In 2014, the four PA members combined registered US$ 567.4 billion in merchandise exports to the world, equivalent to 53% of Latin America and the Caribbean's total merchandise exports.[1] However, PA members trade little with each other. Intra-PA exports reached US$ 19.3 billion in 2014, which is just over 3% of the group's total exports to the world. The PA share is particularly low for Mexico, just exceeding 2% (see table 1a). When the analysis focuses on manufacturing exports only, the PA's overall share is almost identical as for total exports (3.5%). However, there is a clear distinction in this regard between Mexico and the three South American members (Chile, Colombia and Peru). In the case of Mexico (which alone accounts for 94% of the PA's total exports of manufactures), the PA has a similarly low share as a market for its total exports and its manufacturing exports.[2] By contrast, in the case of the other three members, the PA is a much more important market for their manufacturing exports than for their total exports, accounting for a quarter of Chile's industrial exports and for a fifth of Colombia's and Peru's (see table 1b).

Table 1. Pacific Alliance: Total and intra-bloc merchandise exports, 2014
(In millions of dollars and percentages)

a) All products

	Chile	Colombia	Mexico	Peru	Total PA	World	Share PA (%)
Chile		905	1,309	1,853	4,067	76,639	5.3
Colombia	989		914	1,187	3,090	54,795	5.6
Mexico	2,148	4,734		1,730	8,612	397,506	2.2
Peru	1,537	1,228	736		3,501	38,459	9.1
Total PA	**4,674**	**6,867**	**2,959**	**4,770**	**19,270**	**567,399**	**3.4**

1. Mexico alone represented 37% of the region's total exports, with Chile, Colombia and Peru accounting for the remaining 16%.

2. This is not surprising, since manufactures (not including processed natural resources) accounted for 76% of Mexico's total exports to the world in 2014, measured by value.

b) Manufactures [a]

	Chile	Colombia	Mexico	Peru	Total PA	World	Share PA (%)
Chile		251	264	1,108	1,623	6,753	24.0
Colombia	267		587	737	1,591	8,318	19.1
Mexico	1,701	4,109		1,412	7,222	300,717	2.4
Peru	345	388	103		837	4,056	20.6
Total PA	**2,313**	**4,749**	**955**	**3,257**	**11,273**	**319,845**	**3.5**

Source: Author, based on COMTRADE database.

[a] Includes low technology, medium technology and high technology manufactures.

The PA has one of the lowest levels of intra-bloc trade among all Latin American economic integration groups. This cannot be attributed to high trade barriers, as nearly 90% of trade among the four countries is already duty free under bilateral free trade agreements (FTAs) or other economic integration agreements.[3] Other factors seem to play a more important role in this regard. On the one hand, the export baskets of Chile, Colombia and Peru are dominated by raw materials (copper and other mining products in the case of Chile and Peru, petroleum and coal for Colombia), which are exported mostly to extrarregional markets. On the other hand, the PA is not a contiguous economic space. Mexico, the largest market within the group and the only PA member with a predominantly industrial export profile, is geographically distant from its three South American partners. Moreover, its trade is strongly oriented towards participation in US-centred production networks: just 0.9% of Mexico's imports in 2014 came from Chile, Colombia and Peru combined.

An indicator of the importance of value chain trade is the share of intermediate goods (parts and components) in total trade flows. According to this metric, production integration among PA members is quite low: parts and components make up just 7% of total intra-bloc exports (see table 2). By comparison, parts and components account for a third of intraregional trade in East and Southeast Asia (the so-called "Factory Asia") and for nearly 20% of trade

3. These are the Chile-Peru, Chile-Colombia, Chile-Mexico, Colombia-Mexico and Peru-Mexico FTAs, plus the Andean Community agreement between the Plurinational State of Bolivia, Colombia, Ecuador and Peru.

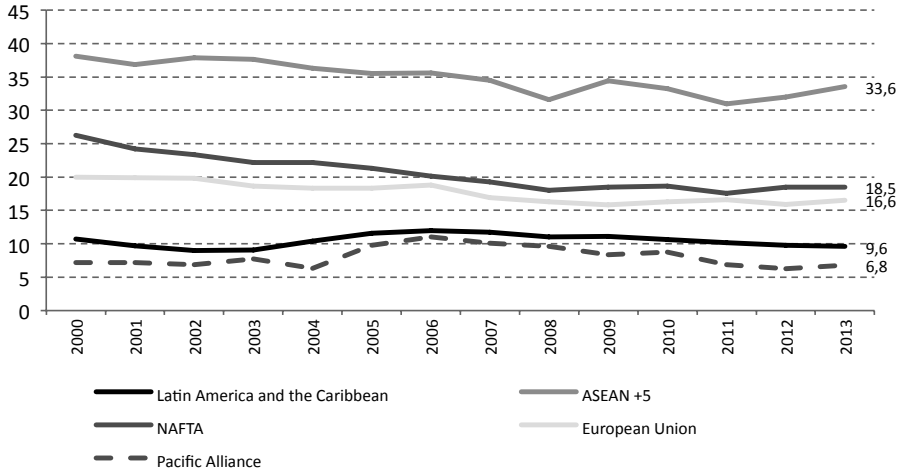
among the members of the North American Free Trade Agreement (NAFTA), of which Mexico is a member (see figure 1).

TABLE 2. Share of parts and components in the Pacific Alliance's intra-bloc trade, 2014
(In percentages)

Destination / Origin	Chile	Colombia	Mexico	Peru	Pacific Alliance
Chile		6.5	2.7	12.0	7.8
Colombia	1.9		6.6	5.8	4.8
Mexico	6.2	7.2		11.6	7.8
Peru	4.4	8.5	4.6		5.9
Pacific Alliance	**4.7**	**7.4**	**4.4**	**10.3**	**7.0**

Source: Author, based on COMTRADE database.

FIGURE 1. Selected groupings: Share of parts and components in total intra-group trade, 2000-2013 [a]
(In percentages)



Source: Author, based on COMTRADE database.

[a] The ASEAN+5 group includes China, Hong Kong (Special Administrative Region of China), Japan, the Republic of Korea, the Chinese Province of Taiwan and the 10 members of ASEAN.

1.2. Trade in Services

Within the PA, only Colombia and Chile have official statistics on trade in services by partner country. Therefore, it is currently impossible to have a full picture of the amount and composition of intra-PA trade in services. Nevertheless, the limited statistics available confirm that the PA is an important market for its members' exports of services.

Colombia's exports of services to the PA reached US$ 1.2 billion in 2014, quite evenly distributed among its three partners: Mexico (36%), Peru (34%) and Chile (30%). This amount is equivalent to 39% of its merchandise exports to the group in the same year. The PA is a relatively more important market for Colombia's services exports than for its merchandise exports: in 2014 it absorbed 16% of the former but only 6% of the latter.

Colombia's exports of services to the PA include several categories of business services (for example, those related to architecture, engineering, agriculture and mining) and IT services. For example, in 2013 the PA absorbed 36% of Colombia's exports of engineering and architectural services and 15% of its exports of IT services (Rosales, Herreros and Durán 2015). Many of these are high-value, knowledge-intensive activities. It is often the case that Colombia simultaneously registers exports and imports of services within these categories with its PA partners (see table 3).

TABLE 3. Main sectors in Colombia's trade in services with the Pacific Alliance, 2013 [a]
(In percentages)

Exports	First	Second	Third	Fourth
Chile	Air passenger transport (53%)	Other air transport services (10%)	IT services (9%)	Telecommunications services (7%)
Mexico	IT services (37%)	Telecommunications services (11%)	Maritime freight transport (8%)	Business franchises (8%)
Peru	Air passenger transport (24%)	Engineering and architectural services (15%)	Air freight transport (14%)	Telecommunications services (10%)

Imports	First	Second	Third	Fourth
Chile	IT services (16%)	Maritime freight transport (13%)	Agricultural, mining and transformation services (13%)	Consulting, management and public relations services (10%)
Mexico	IT services (22%)	Telecommunications services (16%)	Maritime freight transport (13%)	Business franchises (7%)
Peru	Engineering and architectural services (20%)	Other air transport services (20%)	Business franchises (17%)	Air passenger transport (9%)

Source: National Administrative Department of Statistics of Colombia (DANE).

[a] Excluding travel.

Chile's exports of services to the PA (including transport, travel, business, professional and IT services) reached US$ 890 million in 2014 (see table 4). This amount is equivalent to 22% of Chile's exports of goods to the PA in the same year. Although the magnitude of Chile's exports of services to the PA is much lower than that of its merchandise exports, for Chile –same as for Colombia- the PA is a relatively more important market for its services exports: in 2014, it absorbed 11% of total Chilean exports of services, against 5% of its total merchandise exports.

Chilean exports of business, professional and IT services to the PA have been very dynamic in recent years. Although the amounts exported are still not very large (US$ 282 million in business and professional services, and US$ 109 million in IT services, both in 2014), these exports often correspond to high-value, knowledge intensive activities. Between 2008 and 2014, Chile's exports of business and professional services to the PA grew three times as fast as its total exports within this category. As a result, the PA already absorbs over a third of Chile's total exports of business and professional services. In the case of IT services, the PA is an even more important market, accounting for over 40% of Chile's total exports (see table 4c).

TABLE 4. Chile: Exports of services to the Pacific Alliance, 2008-2014
(In millions of dollars and percentages)

a) Transport

Partner	2008	2009	2010	2011	2012	2013	2014
Colombia	119	47	47	61	77	74	77
Mexico	204	68	148	164	139	146	114
Peru	329	245	231	245	190	189	169
Total PA	**651**	**360**	**426**	**470**	**406**	**409**	**360**
World	6,456	4,720	6,394	7,450	6,318	6,087	4,824
Share PA (%)	**10.1**	**7.6**	**6.7**	**6.3**	**6.4**	**6.7**	**7.5**

b) Travel

Partner	2008	2009	2010	2011	2012	2013	2014
Mexico	34	32	44	42	44	45	50
Peru	74	58	66	74	84	73	89
Total PA [a]	**108**	**89**	**109**	**115**	**128**	**118**	**139**
World	1,657	1,604	1,645	1,889	2,150	2,181	2,252
Share PA (%)	**6.5**	**5.6**	**6.7**	**6.1**	**6.0**	**5.4**	**6.2**

c) Other services

Category	Partner	2008	2009	2010	2011	2012	2013	2014	Annual variation (%)
Business, professional and technical services	Colombia	15	7	10	19	24	55	41	18.2
	Mexico	11	12	19	21	26	24	15	5.3
	Peru	103	73	253	335	272	262	226	14.0
	Total PA	**129**	**92**	**281**	**374**	**322**	**341**	**282**	**13.9**
	World	608	493	755	961	897	879	797	4.6
	Share PA (%)	**21.3**	**18.7**	**37.2**	**39.0**	**35.9**	**38.8**	**35.4**	

Category	Partner	2008	2009	2010	2011	2012	2013	2014	Annual variation (%)
IT services	Colombia	11	17	29	33	30	35	39	23.5
	Mexico	17	18	40	46	39	41	44	17.2
	Peru	12	15	11	14	17	20	26	13.8
	Total PA	**40**	**49**	**80**	**93**	**86**	**96**	**109**	**18.2**
	World	127	143	195	230	206	248	260	12.7
	Share PA (%)	**31.3**	**34.6**	**40.9**	**40.6**	**41.7**	**38.7**	**41.9**	

Source: Central Bank of Chile.

[a] Corresponds to the sum of exports to Mexico and Peru, since there are no figures available for Colombia.

The statistics on trade in services taken from a country's balance of payments do not include the sales made within the territory of that country by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and controlled company (for example, a bank, hotel group, construction company, etc.). This is an important omission, since it is estimated that those sales account for about half of world trade in services (Centre for International Economics, 2010). Therefore, in order to have a more accurate picture of intra-bloc trade in services within the PA, it is necessary to analyse FDI flows between its members. This issue is addressed in section 1C, below.

Trade in services is strongly linked with cross-border people mobility, when consumers move abroad to consume services (for example tourists) and when providers move abroad to deliver services (for example, software programmers or architects). Therefore, the lower the barriers to cross-border people mobility, the more opportunities will emerge for trade in services. Against this background, the agreements reached within the PA to facilitate the movement of people are a step in the right direction. An important next step –advocated by the PA's Business Council- would be to advance on the mutual recognition of professional and academic qualifications among PA members. This would make it easier for professionals and other types of specialized workers from one PA member to provide their services in other member countries. For its part, trade in financial services among PA members may be boosted in the coming years by the agreements reached to integrate

the stock exchanges of Chile, Colombia, Mexico and Peru through the Latin American Integrated Market (MILA).

Finally, trade in services among PA members would benefit from a work programme aimed at producing comparable statistics on trade in services by partner, sector and mode of delivery, which today are mostly lacking. Absent those statistics, it is difficult to formulate and implement national policies and joint PA initiatives to exploit the strong potential offered by the services sector.

2. FDI Flows

In 2014, the four PA members combined attracted US$ 68.5 billion in FDI flows, accounting for 43% of the total amount received by Latin America and the Caribbean. In that year, Mexico, Chile, Colombia and Peru were the second, third, fourth and fifth largest FDI recipients within the region, respectively. PA members, particularly Mexico and Chile, are also among the region's largest foreign investors. In fact, since Brazil has registered negative FDI outflows since 2011, PA members currently account for a very high share of Latin America and the Caribbean's total FDI outflows (see table 5).

Table 5. Members of the Pacific Alliance: FDI inflows and outflows, 2014
(In millions of dollars and percentages)

Country	FDI inflows	FDI outflows
Chile	22,002	12,052
Colombia	16,054	3,899
Mexico	22,795	7,610
Peru	7,607	4,452
Total Pacific Alliance	**68,458**	**28,013**
Latin America and the Caribbean	158,803	29,162
Share Pacific Alliance (%)	**43**	**96**

Source: ECLAC (2015), *Foreign Direct Investment in Latin America and the Caribbean 2014*.

Despite their limited trade interdependence, PA members have growing FDI links among themselves (see tables 6 and 7). PA markets are especially important as destinations for PA members' outward FDI. According to figures

by Chile's Central Bank, Colombia, Mexico and Peru together accounted for 16% of Chile's outward FDI stock up to 2013.[4] Chile, Mexico and Peru accounted for 20% of Colombia's outward FDI stock in the same period. Chile, for its part, has been a key market in the expansion of Peruvian firms abroad.

FDI flows are especially dynamic among Chile, Colombia and Peru.[5] For example, two of the largest mergers and acquisitions that took place in Latin America in 2013 involved firms from those countries on both ends of the transaction: the US$ 758 million purchase of Chilean food company Tresmontes Luchetti by Nutresa from Colombia, and the US$ 400 million purchase of Peruvian telecoms company NEXTEL by Chile's ENTEL (ECLAC 2014). In 2014, Corpbanca from Chile purchased Colombia's Helm Bank for US$ 1.32 billion, and Chilean retail chain Falabella purchased Peruvian home-improvement firm Maestro for US$ 712 million (ECLAC 2015: 34). Same as with trade flows, Mexico presents a different pattern from its three PA partners in terms of FDI, as Mexican firms have a much larger presence in the U.S. market. By contrast, just 0.3% of Mexico's inward FDI stock up to 2013 came from PA members.

TABLE 6. Pacific Alliance members: Inward FDI stock from the Pacific Alliance and the world (2013)
(In millions of dollars and percentages)

Origin / Destination	Chile	Colombia	Mexico	Peru	Total PA	World	PA share (%)
Chile		2,081	1,191	163	3,435	215,452	1.6
Colombia	4,683		3,459	543	8,685	123,416	7.0
Mexico	430	486		... [a]	916 [b]	337,595	0.3
Peru [c]	1,475	1,079	457		3,011	23,133	13.0

Source: Author, based on figures from Central Bank (Chile), Proexport (Colombia), National Commission of Foreign Investments (Mexico) and ProInversión (Peru).

[a] Less than 0.1% of Mexico's inward FDI stock.

[b] Corresponds to the sum of Chile and Colombia.

[c] It only includes equity investment, thus excluding reinvested earnings and inter-company loans.

4. Using a different methodology and sources, the General Directorate for International Economic Relations of Chile's Ministry of Foreign Affairs estimates a much larger PA share, reaching 34.9% of Chile's outward FDI stock up to December 2014 (DIRECON 2015, 18-19).

5. Chile was the top foreign investor in Colombia in 2012.

TABLE 7. Pacific Alliance members: Outward FDI stock in the Pacific Alliance and the world (2013)
(In millions of dollars and percentages)

Destination / Origin	Chile	Colombia	Mexico	Peru	Total PA	World	PA share (%)
Chile		5,979	596	9,887	16,462	101,933	16.1
Colombia	2,513		2,833	2,669	8,015	39,662	20.2
Mexico [a]	4,815	3,156		1,248	9,219	131,106	7.0
Peru [b]	367	79	…		446 [c]	1,239	36.0

Source: Author, based on figures from Central Bank (Chile), Proexport (Colombia), and UNCTAD (2014) (Mexico and Peru).

[a] Stock up to 2012.
[b] Stock up to 2010.
[c] Corresponds to the sum of Chile and Colombia.

The increasing importance of PA markets as a destination for capitals originating within the group reflects a wider trend: the growing internationalization of Latin American multinational companies (the so-called *translatinas*), especially during the last decade. Of the 50 largest *translatinas* in 2012 (by total sales), 16 were Mexican, 11 Chilean and 6 Colombian (ECLAC 2014). The internationalization of those companies has focused strongly on the Latin American market. In the case of Chilean, Colombian and Peruvian firms, their investments abroad have taken place mostly in neighbouring countries, from which they have progressively moved on to more distant markets within the region.

There is little official statistical information available in PA countries linking the origin of FDI inflows with the destination of those flows by sector. However, there is evidence that a large part of intra-PA FDI goes to services. For example, it is estimated that 53% of the stock of Chilean FDI in Colombia up to December 2013 went to services, reaching some US$ 9.2 billion (DIRECON, 2014). The most important subsectors are retail (45%), financial intermediation (28%) and transport (15%). It is also estimated that 63% of the stock of Chilean FDI in Peru up to December 2013 went to services, reaching nearly US$ 8.8 billion. The most important subsectors are transport (44%) and retail (36%) (ibid.). Table 8 illustrates the widespread presence of service-sector *translatinas* from Chile, Colombia, Mexico and Peru in those same markets.

TABLE 8. Main services multinational companies from Pacific Alliance members, 2012 [a]

Name	Sector	Chile	Colombia	Mexico	Peru	Sales (US$ millions)
CENCOSUD	Retail	HQ	X		X	19, 116
Grupo Falabella	Retail	HQ	X		X	11, 474
LATAM	Air transport	HQ	X	X	X	9, 722
Sigdo Koppers	Construction	HQ				2, 786
Ripley	Retail	HQ	X		X	2, 411
Entel Chile	Telecommunications	HQ	X		X	2, 398
Salfacorp	Construction	HQ	X		X	2, 220
Sonda	Software	HQ	X	X	X	1, 423
Cruz Blanca SA	Health	HQ			X	982
Lipigas Chile	Gas distribution	HQ	X		X	440
Grupo Sura	Finance	X	HQ	X	X	…
Grupo Aval	Finance		HQ	X		9, 000
Empresas Públicas de Medellín	Electricity and telecommunications	X	HQ	X		7, 049
Avianca	Transport		HQ		X	4, 294
Grupo Carvajal	Graphic industry	X	HQ	X	X	1, 813
América Móvil	Telecommunications	X	X	HQ	X	59, 778
Ingenieros Civiles Asociados (ICA)	Construction	X	X	HQ	X	3, 667
Grupo Saba	Retail			HQ		3, 601
Grupo ACP	Microfinance				HQ	…

Source: Author, based on ECLAC (2014) and information from the international financial press.

[a] HQ: Headquarters. An X means the firm has established a commercial presence in the country.

3. The Pacific Alliance in the Context of Latin American Regional Economic Integration

For Latin America and the Caribbean, diversifying its production and export structure is an urgent development imperative. The opportunities to do so are intimately linked to the prospects of its regional integration process. This is so because, among other reasons, intraregional exports are more diversified, have a higher share of manufactures and are more accessible to small and medium enterprises (SMEs) than extrarregional exports. There is thus a clear link between the structural change the region needs to go through and the deepening of the regional economic space.

Despite more than 5 decades of efforts to build an institutional framework for regional economic integration, intraregional trade in Latin America and the Caribbean reaches just 18-19% of the region's exports to the world, well below the levels achieved in the world's three main "factories": North America (50%), East and Southeast Asia (50%), and Europe (over 60%). Production integration is also scarce within the region, as evidenced by the low share of parts and components in intraregional trade (10%). This means that the well documented benefits of intraregional trade are significantly under-exploited. As already seen in section 1, intra-PA trade shares –even to a larger extent– these common regional features.

While the Latin American market remains fragmented in multiple economic integration initiatives, each with its own rules for trade and investment, other regions are moving towards deepening their own integration processes. Illustrative of this trend are several "mega regional" trade negotiations underway: the U.S.-led Trans Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States, and the Regional Comprehensive Economic Partnership (RCEP) project in East and Southeast Asia. These "mega regional" negotiations are to a large extent an attempt to define common rules for modern value chain trade, with a particular emphasis on regulatory aspects.

If they succeed, mega-regional negotiations will likely have a profound impact on the geographical distribution and governance of global trade and investment flows in the coming years. The magnitude of these initiatives could mean that by 2020, the rules of international trade will have been largely rewritten. However, such a scenario would differ substantially from the most recent global negotiation of this kind (the GATT Uruguay Round, completed in 1994) in that this time the new rules would have been negotiated outside the

multilateral framework and among a limited number of countries (Rosales and Herreros 2014). This prospect by itself should be a matter of concern for Latin American countries, which–with few exceptions–are largely absent from both international production networks and mega-regional negotiations.[6] If these negotiations are successfully concluded, the magnitude, composition, and direction of Latin American countries' trade (and investment) flows are likely to change, affecting both participants and non-participants. South America in particular risks deepening its already high dependence on commodity exports.

Against the above background, Latin America and the Caribbean face a pressing need to build bridges between its multiple economic integration mechanisms. The most urgent task is to tackle the current fragmentation of the regional market, so as to promote the development of regional value chains. The different views on integration that coexist today in the region cannot be an obstacle for this task. With a high dose of pragmatism and a long-term, strategic view, "convergence within diversity" can be achieved. This is why ECLAC supports the initiative –first articulated by the government of Chile in 2014- to launch a work agenda for gradual convergence between the PA and MERCOSUR.[7] Since these are the region's two largest economic integration mechanisms, any agreements reached between them could serve as a basis for subsequent extension to other countries or groupings (for example, Central America).[8] In other words, convergence between the PA and MERCOSUR could serve as a catalyst for larger, region-wide integration initiatives.

As a contribution to the debate on convergence between both blocs, ECLAC has identified several areas where the PA and MERCOSUR stand to gain from working together. It has proposed to start work in areas which are relatively uncontroversial and which could deliver tangible benefits to all parties in the short term, such as people mobility, trade facilitation and mutual recognition of sanitary, phytosanitary and technical standards. Other areas aside from trade where both blocs could work together include transport, energy, sustainability, tourism, science, technology and innovation, among others. In time, the members of both blocs could even contemplate coordinating their

6. Only 3 countries from the region (Chile, Mexico and Peru, all PA members) participated in a mega-regional negotiation (the TPP).

7. The first two exploratory meetings between both groups –at the Foreign Ministers' level–took place in Cartagena de Indias (Colombia) and Santiago (Chile) in November 2014.

8. Both blocs include the region's seven largest economies, jointly accounting for over 80% of its total population and trade, and for over 90% of its GDP.

national industrial policies to promote certain priority value chains, as well as jointly reaching out to Asia Pacific (ECLAC 2014b: 70-75).

4. The Pacific Alliance and Asia-Pacific: Which Way Forward?

Among Latin American regional integration forums, a unique feature of the PA is that it partly defines itself in terms of its intended links with another region: Asia-Pacific (Herreros 2015). Specifically, the PA aims at becoming a bridge between both regions. Probably in response to this goal, 9 countries from Asia-Pacific have become observers in the PA, including all the main players in that region.[9]

A natural starting point to design a PA strategy towards Asia-Pacific is to look at trade relations. PA members (especially Chile and Peru) have been very active in negotiating trade agreements with Asia-Pacific economies (see table 9). Moreover, three PA members (Chile, Mexico and Peru) are the only Latin American members of the Asia-Pacific Economic Cooperation forum (APEC). However, trade links with Asia are not equally important for all PA members. While Asia-Pacific accounts for almost half of Chilean total exports and almost a third of Peru's, it is a much less important market for Colombia and a minor one for Mexico. Chile's and Peru's export baskets are complementary with those of China, Japan and Korea, exchanging minerals for industrial products. By contrast, Mexico directly competes with Asian (especially Chinese) manufactures in its own market and the United States (Dussel Peters and Gallagher 2013). Colombia is in an intermediate position. Overall, Chile posts a trade surplus with Asia Pacific, while the other three PA members show deficits, with Mexico's being very high (see table 10).

9. Australia, China, India, Indonesia, Japan, New Zealand, Republic of Korea, Singapore and Thailand.

TABLE 9. Pacific Alliance members' FTA network with Asia Pacific, as of August 2015

	China	Japan	Republic of Korea	Others (in force)	Others (under negotiation)
Chile	Yes	Yes		Australia, Hong Kong (SAR China), India, Malaysia, P4 [a] Thailand, Vietnam	TPP, Indonesia
Colombia	No	Under negotiation	Yes [b]		
Mexico	No	Yes			TPP
Peru	Yes	Yes	Yes	Singapore, Thailand	TPP

Source: Organization of American States, Foreign Trade Information System, www.sice.oas.org.

[a] Trans-Pacific Strategic Economic Partnership Agreement. Its members are Brunei Darussalam, Chile, New Zealand and Singapore.

[b] Signed in 2013, still not in force.

At least for now, the PA is not seen by its members as a forum to jointly negotiate trade or investment agreements with other countries or groupings. This raises the question of what kind of work agenda the PA can propose to its Asian observers. Joint promotion of business opportunities with PA countries is a promising area already being explored. In particular, PA members should join efforts to attract Asian FDI and help their own multinational companies to increase their presence in Asia. Reaching arrangements with Asian partners to help diversify PA members' highly concentrated exports to that region should also be a priority. Since the PA's Asian observers are very diverse, a "one size fits all" agenda should be avoided. The PA could instead propose to each of its main Asian observers (at least China, Japan, India and the Republic of Korea) the creation of bilateral forums on trade, investment and cooperation. These bodies could meet regularly, allowing both parties to tailor their agenda to their specific needs and interests. A similar arrangement should be proposed to ASEAN, given its centrality in Asia Pacific's regional integration efforts.[10]

10. A first step in this direction was taken on 26 September 2014, when the PA's Ministers of Foreign Affairs and Trade met a high-level delegation of ASEAN at the margins of the UN General Assembly. Both groups discussed possible avenues for future cooperation.

TABLE 10. Pacific Alliance members' merchandise trade with Asia Pacific and the world, 2013
(In million dollars and percentages)

	China	Japan	Rep. Korea	ASEAN-6[a]	India	Total Asia Pacific [b]	World	Share Asia Pacific (%)
Exports								
Chile	19,219	7,661	4,272	1,285	2,304	34,741	77,367	44.9
Colombia	5,102	388	230	259	2,993	8,972	58,822	15.3
Mexico	6,467	2,242	1,525	1,601	3,812	15,648	380,123	4.1
Peru	7,343	2,228	1,541	496	593	12,201	41,872	29.1
Imports								
Chile	15,702	2,495	2,771	1,604	739	23,310	79,616	29.3
Colombia	10,363	1,479	1,296	1,204	1,144	15,486	59,381	26.1
Mexico	61,321	17,076	13,493	15,385	2,868	110,144	381,210	28.9
Peru	8,399	1,439	1,590	1,283	723	13,434	43,357	31.0
Balance								
Chile	3,517	5,166	1,501	-318	1,565	11,431	-2,249	…
Colombia	-5,261	-1,091	-1,066	-945	1,849	-6,514	-559	…
Mexico	-54,854	-14,834	-11,968	-13,784	944	-94,496	-1,087	…
Peru	-1,056	789	-49	-787	-131	-1,233	-1,486	…

Source: COMTRADE database.

[a] Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

[b] Corresponds to the sum of China, Japan, Korea, ASEAN-6 and India.

In a mid-term perspective, another crucial issue will be defining where and how the PA fits into the emerging architecture of trans-Pacific economic relations. In this regard, the relationship between the PA and the TPP becomes strategically important. Chile, Mexico and Peru participate in the TPP negotiations, while in the past Colombia has expressed interest in joining them. The large potential overlap between both initiatives in terms of membership and thematic coverage raises important systemic questions.[11] At the time of writing, the prospects for successful conclusion of the TPP negotiations remain

11. Some authors already envisage an explicit institutional link between the PA and the TPP. For example, Rashish (2014) argues that, should Costa Rica and Panama want to join the TPP in the future, they should first become full members of the PA.

unclear. Nevertheless, the issue of how to handle the relationship between both processes will likely remain a critical one in the coming years.

Conclusions

The PA has many unique features. Firstly, it is Latin America's only integration mechanism (aside from its predecessor, the Latin American Pacific Arc) that explicitly includes among its goals strengthening links with another region (Asia-Pacific). Secondly, it aims to build a "deep integration area" while explicitly avoiding the goal of creating a customs union. It thus departs from the traditional notion according to which deeper forms of integration are usually preceded by the harmonization of tariffs and the adoption of a common trade policy towards non-members. Thirdly, its membership does not correspond to any particular region (aside from the fact that all its members share coasts on the Pacific).

The creation of the PA responded partly to the recognition that it made sense to join forces to better exploit the opportunities presented by the rise of Asia. Therefore, it follows that PA members should coordinate when interacting with Asian partners. Thus far such coordination has mostly been through joint participation in seminars and in trade, investment and tourism fairs, as well as arrangements to share embassies or trade offices in some countries. While all these initiatives are welcome, they do not constitute a full-fledged strategy towards Asia-Pacific. In the absence of such strategy, the PA will find it difficult to realize its potential to become the main springboard for Asia – Latin America trade, investment and cooperation. Therefore, defining a strategy towards Asia is a key challenge for the PA.

Trade interdependence among PA members is quite low, especially between Mexico and its three South American partners. This somehow limits the PA's business appeal and poses the question of how to sustain its momentum in the medium term. This is a second key challenge going forward. In this regard, the PA becomes a much more interesting partner if it can market itself as a privileged springboard from which to do business with the rest of Latin America. As already explained, this requires reaching out to MERCOSUR, which accounts for over half of the region's GDP.[12]

12. In fact, both Chile and Colombia export more to MERCOSUR than to the Pacific Alliance.

Achieving convergence between the PA and MERCOSUR will be a challenging exercise, both technically and politically, given the different policy orientations both blocs have today. However, the more successful the PA proves in engaging MERCOSUR in a joint work agenda, the more attractive it should become to Asian trade and investment partners, for many of which Brazil is their top Latin American trading partner. In other words, the PA has a key role to play both in helping to achieve a more integrated Latin America and in serving as a bridge between the region and Asia-Pacific. Both agendas are not mutually exclusive, and in fact reinforce each other.

A third key challenge for the PA will be managing its relations with other economic integration initiatives in which some of its members participate. For example, Colombia and Peru are members of the Andean Community, one of the oldest economic integration mechanisms in Latin America. Both countries will need to manage carefully any potential inconsistencies arising from their parallel membership in the two groupings (for example, if in certain areas they grant the other PA members more favourable treatment than that accorded to their fellow Andean Community partners). Getting the relationship right between the PA and the TPP will be also crucially important. For the PA to play an effective role in the broader process of Latin American economic integration in the coming years, it will need to retain its autonomy from the TPP, since the latter is not a Latin American-led initiative.

A fourth challenge relates to whether, or how much, to expand the PA's work agenda beyond its current, mostly economic focus. This issue relates in turn to the institutional dimension. Thus far the PA has a very light institutional framework, with no permanent Secretariat. It remains an open question whether this arrangement will be able to effectively deal with a heavier integration agenda in the coming years.

Finally, there is the issue of enlargement. Unlike most Latin American and Caribbean economic integration blocs, the PA's membership is not primarily defined by geography. Instead, it has been defined mostly by shared visions in terms of economic policy. This facilitates reaching agreements within the group; however, it could make accession more challenging for candidate countries. Therefore, PA members may need to assess the group's accession policies going forward.

Overall, the PA's main challenge for the coming years may be living up to the big expectations it has aroused so far. Three main, interrelated yardsticks can be identified in this regard. Firstly, how much the PA can contribute to diversifying the economies and exports of its members, which in the case of

Chile, Colombia and Peru are increasingly dependent on commodities. Secondly, how the PA can support efforts towards larger-scale Latin American integration. Finally, how effective the PA proves to be in its intended role as a bridge between Latin America and the dynamic economies of Asia-Pacific.

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TRADE, INVESTMENT AND SMES AS ENGINES FOR GROWTH IN THE PACIFIC ALLIANCE

Gabriela Ramos

1. Introduction

Since the turn of the 21st century, the growing interdependence and interconnectedness of global economies has been accompanied by an intensification of regional economic integration. Recent data indicate that the number of regional trade agreements notified to the WTO stands at 262, the highest figure to date.[1] There are a number of factors behind this trend. These include: increased participation of global value chains (GVCs); the need for securing export and investment markets; the need for accelerating restructuring and opening of the economy; and strengthening of political and economic ties among neighbouring countries. In this context, there is a growing opportunity cost of being excluded from regional economic integration initiatives.

Trade and investment integration can bring about major benefits to the countries involved, improving resource allocation, creating economies of scale and scope, and promoting knowledge transfer. It can also be a driving force for structural reform, contributing to removing regulatory restrictions to competition and reducing administrative burdens on companies. Indeed, in the majority of the regional agreements formed in the 21st century, the objectives went beyond reducing obstacles to trade in goods and services, including a broader goal to increase the transparency and efficiency of their economies. At the same time, integration raises some complicated socioeconomic issues, covering a wide range of areas such as gender, environment, labour and cultural exchanges. To draw the maximum benefit from regional economic integration across the population, countries must also accompany the process with initiatives to

1. This number indicates all physical RTAs in force, sorted by Coverage (Goods, Services, Goods and Services). For more details, please visit http://rtais.wto.org/UI/publicsummarytable.aspx

promote skills, to develop the physical infrastructure, but also to ensure that the highest standards of responsible business conduct are pursued.

The Pacific Alliance, launched by the political leaders of four Latin American countries (Chile, Colombia, Mexico, and Peru) in June 2012 is one of the most prominent recent examples from this trend towards regional integration. Within three years of its operation, the Pacific Alliance has made strides in stimulating both individual and collective economic reform and supporting inclusive and sustainable growth. Domestic policy reform has advanced in tandem with the strengthening of the regional economic framework. These four member countries are already signatories to the existing bilateral FTAs, and have been promoting market-driven trade and investment policy measures as engines for growth for decades. Their comprehensive reform agenda, supported by strong political commitment, has underpinned the Pacific Alliance's potential to be a regional standard setter. At the same time, the Alliance is well placed to benefit from strengthening economic cooperation with the Asia-Pacific market. These links will contribute to improve economic perspectives of these economies, that have been affected by the financial crisis. Indeed, OECD forecasts suggest that "the pace of Latin American economic growth will be the slowest in the past five years" and stressed the importance of continued structural reforms in order to boost potential output and equity (pp. 15 OECD 2015c).

This chapter will begin with a review of the key characteristics and economic implications of the Pacific Alliance, followed by an assessment of the role of trade, investment and SMEs in the integration process. It will identify the main challenges in strengthening intra-regional dynamics. Policy implications will be drawn and concrete areas and ways in which the OECD can support these endeavours will be suggested.

2. The Pacific Alliance: New Approaches to the Regional Integration Model

Background and Objectives

Regional agreements are not a new concept to most Latin American and Caribbean (LAC) countries. However, the Pacific Alliance has developed a

different model of regional cooperation as defined by its objectives.[2] Compared to other conventional regional bodies in this region, such as MERCOSUR and ALBA, the Pacific Alliance embodies the following unique characteristics.

First, the framework looks reminiscent of the very early stages of the EU integration model, in that it emphasises the free movement of tangible and intangible resources including goods, services, capital, human resources and knowledge (technology and innovative skills). It also aims to achieve a political articulation and financial integration. To serve this purpose, the agenda encompasses a wide array of activities to deepen integration and horizontal cooperation. These include research on climate change and transportation infrastructure, student and scholar mobility and the facilitation of migration flows.

Second, the four members on the Pacific coast share the common goal of gaining market efficiency by taking advantage of complementarities and economies of scale. They are endowed with a wide range of natural resources and built their agreement on an existing market-driven *de-facto* and *de-jure* integration process. Members realised that an inward-looking type of *de-facto* economic integration is not in their own interests, since it deflects their economies away from the path of free and open markets. In this regard, the non-discrimination and non-preferential guiding principle was adopted, leading to an open form of regionalism.

The concept of open regionalism originated in APEC and became prevalent in Latin America in the 1990s. Ross Garnaut (2004) describes it in the context of Asia Pacific economic cooperation. He noted "Open Regionalism" was the term that came to describe Asia Pacific economic cooperation and the approach to trade facilitation and liberalization in the late 1980s and 1990s. It emerged from early Asia Pacific discussions on regional trade expansion with a precise meaning: the removal of barriers to and the encouragement of regional cooperation without discrimination against outsiders." This definition of open regionalism places greater emphasis on an outward growth strategy

2. The objective of the Pacific Alliance are as follows: i) To build, through consensus and participation, an area of deep integration in order to move towards the free circulation of goods, services, capitals and people, ii) To bolster greater growth, development and competitiveness of the members' economies, in order to achieve greater wellbeing, overcome socioeconomic inequality and attain social inclusion of their inhabitants, iii) To become a platform for political articulation, economic and commercial integration, and outreach to the world, with emphasis on the Asia-Pacific region. Source: The Pacific Alliance, The ABC of the Pacific Alliance; retrieved at http://alianzapacifico.net/wp-content/uploads/2014/02/ABC-de-AP-INGLES.compressed.pdf

and the building block nature of regionalism that prevailed in the 1990s both in Latin America and Asia. In practice, such an outward-looking policy minimizes the negative impact of trade diversion and makes the regional market more competitive. Against this backdrop, the idea of open regionalism has evolved into the realm of behind-the-border issues, service, labour, climate and environment cooperation, which are the main components of regional integration in the 21st century.

Third, the term open also implies inclusiveness of membership and partners. Member countries aim to strengthen trade agreement networks either by providing non-members with the opportunity to gain full membership or to participate in meetings as observers.[3] More than 30 countries across the world have gained official observer status to date. The group aims to achieve its policy target by strengthening inter-regional cooperation with the most developed and dynamic economies of the world, with special emphasis on the Asia-Pacific region.

Fourth, in an effort to achieve greater well-being and inclusiveness, the group has adopted inclusive integration and placed particular consideration on strengthening the competitiveness and innovation of SMEs. In line with this, the Pacific Alliance seeks to achieve its growth target by accelerating its inclusive market reform agenda giving SMEs more efficient integration into regional production networks and GVCs. This will bring great opportunity for the regional economy to create new jobs and improve welfare. Given the importance of SMEs as engines of job creation and balanced, inclusive growth, in May 2013, the Leaders of the group called for the creation of supporting mechanisms to allow SMEs to share in the benefits offered by the Pacific Alliance.[4]

Key Initiatives and Progress

In its first 3 years, the Pacific Alliance appears to have taken a pragmatic approach to economic integration. Table 2.1 summarises important progress

3. Costa Rica and Panama are in the process of taking necessary steps to gain full membership of the Pacific Alliance.

4. As a follow up, the Technical Group of Small and Medium-Sized Enterprises (SME) was designed to support, strengthen, and modernize small and medium-sized enterprises. Source: http://alianzapacifico.net/en/pymes/.

and achievements in several areas. The progress in market access has been swift and remarkable. In January 2013, the High Level Group (HLG) agreed to eliminate 90% of tariffs on intra-trade goods. Building on the agreed goals outlined in existing FTAs, the leaders of the four members further agreed to expand the coverage by an extra 2% in 2014. The remaining 8% of goods will be phased out within a short to medium-term period, depending on market conditions and sensitivity.

Capital market integration predates the establishment of the Pacific Alliance. In 2009, Chile, Colombia and Peru initiated the process of setting up a regional market to trade equities. The Latin American Integrated Market (MILA) was launched as the joint stock exchange between participating members. Mexico became an official member in January 2015. The integration of the stock exchanges, markets and depositories of Chile, Colombia, Mexico and Peru, aims to promote the growth of trading activity in the member countries, providing an efficient and competitive infrastructure, better and greater exposure of their markets and a better offer of products and opportunities for local and foreign investors. The Pacific Alliance's cross border initiative to deepen capital market integration will reinforce MILA and extend its reach further.

Table 2.1 Examples of Progress and Achievements

Area	Major Progress and Achievements
Market Access	– Agreement of tariffs elimination on 90% of tariff line traded among members by March 2013. – In 2014, agreement to eliminate extra 2% and gradually phase out the remaining 8%.
Capital Market Integration	– Mexico became a member of Launch of Latin American Integrated Market (MILA).
Mobility of Human Resources	– Introduced Visa waiver program among members
Organisation Structure	– Establishment of Council of Ministers, High level Group, Technical Groups and Subgroups
Institutional and Administrative Arrangement	– Establishment of the Pacific Alliance Business Council – Establishment of cooperation measures in Consular Assistance – Opening of Shared Embassies

Source: http:/alianzapacifico.net

Note: Constructed by the author.

Free movement of human resources is critical to the realisation of the Pacific Alliance's vision and the economic development of its members. For example, tourist visa requirements for nationals of member countries have already been waived. Peru has eliminated business visas for members to facilitate access to its market. With a view to promoting the academic mobility of students and scholars, a scholarship award programme was introduced and is currently underway.

3. The Three Engines of Growth in the Pacific Alliance: Trade, Investment and SMEs

Trade Patterns and Structures

The four member countries together comprise 214 million people, representing 3% of the world population. Their combined gross domestic product of $2.1 trillion in 2013 represents 37% of Latin America's total GDP and half of its exports. From 2010 to 2013, they had an average annual growth rate of 5.1% (Source: OECD, IMF, World Bank, ECLAC). In 2013, Pacific Alliance members' foreign trade added up to more than $1.16 trillion. More specifically, Table 3.1 shows that the Pacific Alliance's total exports expanded from $295 billion in 2005 to $557 billion in 2013, an expansion of trade volume by 1.9 times in 8 years. Over the same period, Colombia experienced an expansion of 2.8 times of its merchandise trade followed by Peru (2.42 times), Chile (1.82 times) and Mexico (1.77 times). In 2013, all four members ran deficits in merchandise trade. The relative underperformance of 3 members (Chile, Colombia and Peru) was due to a deterioration of terms of trade as a result of declines in natural-resource prices.[5] The Pacific Alliance's global trade share has been stagnant for some time at around 3% while its share of APEC trade has remained at about 6% for both exports and imports.

5. Chile reveals significant comparative advantages on non-ferrous metals, metalliferous ores and metal scrap, and pulp and waste paper, which RCA index are 31.6, 28.0 and 27.7 respectively (see annex). Colombia has robust comparative advantages on coal, coke and briquettes, crude animal and vegetable materials, and coffee, tea, cocoa, spices, and manufactures thereof, with 32.6, 15.7 and 14.3 as RCA index, respectively. Mexico presents comparative advantages on road vehicles (5.3 RCA index), and telecommunications and sound-recording and reproducing apparatus and equipment (5.0). Peru has substantial comparative advantages on animal oils and fats (48.5), metalliferous ores and metal scrap (28.9), and gold (20.5). For more details please refer to Box 1.1 from OECD (2015d).

TABLE 3.1 Trends in Trade of Major Regional Groups and the share of the Pacific Alliance
(Millions US dollar, Percentage)

	Exports (Goods)			Imports (Goods)		
	2005	**2010**	**2013**	**2005**	**2010**	**2013**
Chile	41,974	71,109	76,684	32,925	59,207	79,178
Colombia	21,092	39,552	58,822	21,131	40,683	59,397
Mexico	214,233	298,473	380,027	244,001	331,630	419,331
Peru	17,291	34,909	41,919	13,206	33,139	48,037
PA total	294,590	444,043	557,452	311,264	464,659	605,943
APEC	4,684,854	7,207,226	8,855,675	5,119,889	7,430,059	9,315,271
EU	4,090,470	5,015,087	5,843,320	4,162,240	5,216,353	5,792,593
World	10,392,621	14,925,329	18,227,587	10,758,761	15,325,448	18,685,082
	PA's Trade Share					
PA/World	2.8%	3.0%	3.1%	2.9%	3.0%	3.2%
PA/APEC	6.3%	6.2%	6.3%	6.1%	6.3%	6.5%

Source: Database from CEPALSTAT, IMF Department of Trade Statistics (DOTS)
Note: Own calculation

Table 3.2 shows trade shares[6] and trade dependency of Pacific Alliance members. Trade dependency,[7] a ratio of foreign trade to Gross Domestic Product, for all members peaked in 2013, indicating that a considerable portion of members' growth performance is dependent on foreign trade. This also explains why Pacific Alliance members have benefited to a high degree from trade liberalisation efforts.

6. Member's volume of trade with particular regional group/member's total volume of trade.

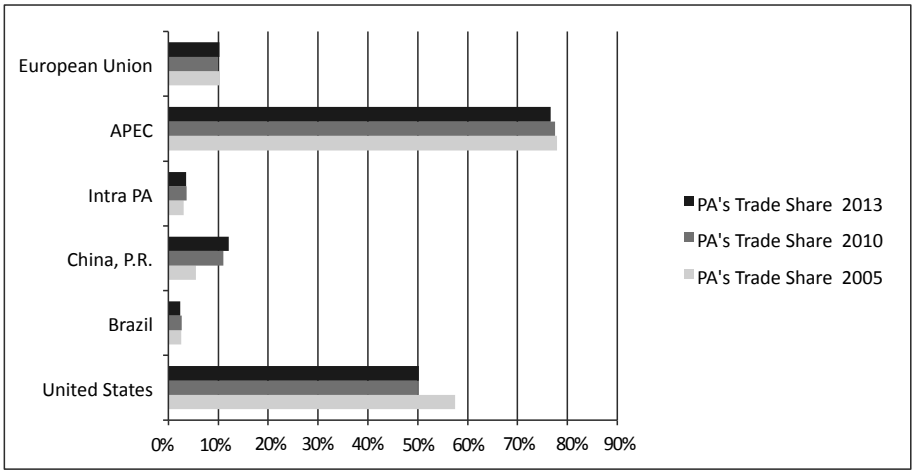
7. This indicator measures a country's "openness" or "integration" in the world economy. The trade-to-GDP-ratio is often called the "trade openness ratio." However, the term openness to international competition may be somewhat misleading. In fact, a low ratio for a country does not necessarily imply high (tariff or non-tariff) obstacles to foreign trade, but may be due to the factors mentioned above, especially size and geographic remoteness from potential trading partners.

TABLE 3.2 Intra-regional and Interregional Trade Shares of Pacific Alliance Members
(Percentage)

	Chile			Colombia			Mexico			Peru		
	2005	**2010**	**2013**	**2005**	**2010**	**2013**	**2005**	**2010**	**2013**	**2005**	**2010**	**2013**
Chile	0.00%	0.00%	0.00%	1.59%	2.05%	2.09%	0.57%	0.64%	0.46%	5.81%	3.71%	3.48%
Colombia	0.93%	1.76%	1.66%	0.00%	0.00%	0.00%	0.50%	0.74%	0.72%	3.78%	3.31%	2.73%
Mexico	3.21%	3.10%	2.47%	5.59%	5.60%	5.38%	0.00%	0.00%	0.00%	2.60%	2.23%	2.79%
Peru	2.78%	2.30%	2.35%	2.50%	2.39%	1.81%	0.18%	0.21%	0.30%	0.00%	0.00%	0.00%
Intra-regional Trade Share	6.92%	7.16%	6.48%	9.68%	10.04%	9.29%	1.25%	1.59%	1.48%	12.19%	9.25%	9.01%
Trade to GDP Ratio	40.86%	59.90%	61.72%	18.36%	27.95%	35.48%	48.05%	60.01%	69.43%	28.94%	46.27%	51.28%
Interregional Share												
United States	15.81%	13.00%	16.59%	35.11%	34.28%	29.71%	68.52%	63.19%	63.23%	25.46%	17.85%	19.19%
Brazil	7.58%	6.82%	6.12%	3.60%	4.25%	3.54%	1.45%	1.36%	1.28%	4.96%	4.92%	4.76%
China, P.R.	10.84%	20.95%	22.28%	4.38%	9.28%	13.08%	4.50%	8.63%	9.25%	9.92%	16.24%	18.42%
APEC	52.58%	60.40%	61.24%	57.38%	62.04%	58.50%	85.34%	85.14%	84.31%	57.28%	57.45%	59.62%
European Union	20.06%	15.72%	15.53%	13.62%	13.36%	14.62%	8.06%	7.81%	8.15%	15.18%	14.34%	14.25%

Source: Database from OECD, IMF DOTS, CEPAL (Own calculation)

FIGURE 3.1 Pacific Alliance's Trade Share with Major Partners



Source: Database from OECD, IMF DOTS, CEPAL (Own calculation).

The sharp contrast between intra-regional and interregional trade shares of the four members gives some indication of their trade performances with respect to the degree and direction of market integration.

First, intra-regional trade share in the Pacific Alliance is relatively low although the four members are linked by bilateral trade agreements. As shown in Figure 3.1, in 2013, the intra-regional trade share in the Pacific Alliance stood at around 3.5%, up only marginally from around 3.1% in 2005.[8] Mexico had the lowest share as its intra-regional trade share accounted for a level of only about 1.5% in 2013, explained by its deep relationship with the US market (Table 3.1). This is notable, considering that it is the economy among the four members who has a larger participation in international trade.

Secondly, it should be noted that the Asia-Pacific region is the largest destination and source of members' trade activities. In 2013, for example, the share of merchandise trade of Chile, Colombia, Mexico and Peru from trade with APEC members was 61.2%, 58.5%, 84.3% and 59.6%, respectively. Looking into the trade pattern of individual member countries offers a clearer picture of the Pacific Alliance's high dependency on the Asia Pacific market. In 2013, Chile's most important trading partner was China (22.3%),

8. Own calculation based on online IMF DOTS database available at: http://elibrary-data.imf.org/QueryBuilder.aspx?qb=ce5e26cdef7a7eda5930f43265d159e3

the United States (16.6%) and the EU (15.5%). The combined shares of trade with China and the U.S.A. make up about 39% of Chile's merchandise exports and imports. With almost 30% of the share, the United States is Colombia's most important trading partner. In the case of Mexico, other Pacific Alliance members are minor trade partners. Mexico's trade is predominantly with the United States. Peru maintains its intra-regional trade share at a level of 10% over the period observed, while its trade share with China increased from 9.9% in 2005 to 18.4% in 2013.

The share of bilateral trade of Pacific Alliance members with China rose significantly from 2005 to 2013. China is an important trade partner for Chile (22.3%) and Peru (18.4), and to a lesser extent for Colombia (13.1%) and Mexico (9.3%). Three members of the Pacific Alliance, Chile, Mexico and Peru, are members of the Pacific APEC and participate in TPP negotiations with other key trading partners on the Pacific coast. This gives them great potential to deepen and extend their Global Value Chains (GVCs) towards the Asia Pacific region.

Investment: FDI Linkages and Environment in the Pacific Alliance

Over the past decade, FDI to the Pacific Alliance has grown almost twice as fast as flows to all emerging markets, and the four member countries have captured more than 51% of total FDI flows to Latin America in 2000-13. According to the World Investment Report (UNCTAD, 2014), Mexico, Chile and Colombia were within the world's top-20 recipients of FDI flows in 2013, with inflows totalling USD 38bn, USD 20bn and USD 17bn , respectively, and ranking, after Brazil, as the next top recipients in the region. Peru occupied the fifth position in the region, with USD 10bn. There is considerable potential for raising intra-PA FDI flows, currently equal to only 3% of total FDI received from all sources, and mostly attributable to the activities of Chilean "multilatinas."

If well connected with the local economy, FDI inflows bring the host countries not only financial resources but also new technologies and management skills, with spillover effects which contribute to promoting economic growth. FDI inflows also bring various important networks, including procurement and sales networks, which enable host countries to achieve an efficient production and distribution of their products.

Global value chains (GVCs) have become a dominant feature of world trade and investment, offering new prospects for growth, development and jobs. Countries with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs and to generate relatively more domestic value added from trade (OECD, WTO, UNCTAD, 2013, p. 23). In this context, the level of FDI inflows is often utilised as one of the indicators to gauge the soundness of a country's economic performance.

In the Latin American Economic Outlook 2015, the OECD sets out two conditions for FDI to create positive ties with foreign markets: "Investment must be channelled towards the most technology-intensive sectors or activities, and beneficiary countries need an environment that is conducive to spillovers and linkages with the rest of the economy. Both aspects require an institutional environment and policies that prevent new technologies from becoming an enclave with scant linkages to the rest of the production system" (OECD, 2015c).

From its outset, the Pacific Alliance has launched proactive initiatives to increase the attractiveness of the group to foreign investors. Concrete initiatives include the activities of the Committee on Trade and Investment and of the Working Group on Services. A joint committee composed of an investment subcommittee and a service trade committee was established to improve the institutional and policy environment for investment through enhanced cooperation and exchange of information. There is also healthy competition among national and sub-national Investment Promotion Agencies, as well as collaboration in high-level forums like those organised in New York in 2013 and in Miami in 2014, where the four Heads of State jointly promoted the Pacific Alliance. At a country level, it is important to pursue a solid agenda of structural reform that will increase the competitiveness and productivity of the economies in the Pacific Alliance. In the context of slow growth in many regions, and of the demographic trends with the ageing of the population in some emerging economies, the Pacific Alliance members can position themselves as an interesting destination. To do so, the structural reform agenda needs to be advanced and effectively implemented.

The roadmap on what is needed for investment promotion is clear, but less so in facilitation and after-service activities. The experience with single-window initiatives is mostly limited to foreign trade. In this area, the margins for doing better are considerable, especially in view of the significant gaps that still exist – for instance, it takes 54 days on average to obtain a construction

permit in Colombia and more than three times longer in Peru, at 173 days (OECD, 2014b). Progress is possible; however, for example, in recent years, Mexico has significantly reduced the red tape and the number of days required to obtain one.

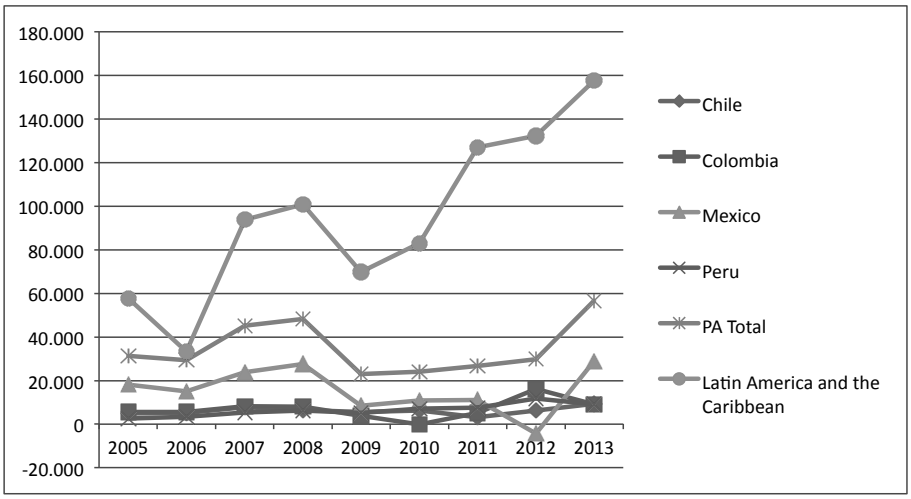
For an integration of promotion and facilitation functions, institutions and high-level leadership matter for policy coordination and coherence. Best practices can be identified from global (e.g. OECD, IFC) and regional (e.g. APEC) sources. Sharing of experiences also takes place within the World Association of Investment Promotion Agency (WAIPA), where the Latin American chapter is chaired by the IPA of Barranquilla and the Atlántico Region, a private non-profit organisation funded by the local government and more than 80 sponsoring-companies.

TABLE 3.3 Net Inflows of Foreign Direct Investment
(Millions of US dollars)

Country/ Group	2005	2006	2007	2008	2009	2010	2011	2012	2013
Chile	4,962	5,214	7,720	6,367	5,654	6,264	3,192	6,212	9,335
Colombia	5,590	5,558	8,136	8,110	3,789	-147	5,101	16,135	9,120
Mexico	18,234	15,132	23,953	27,528	8,383	10,848	10,992	-4,339	28,955
Peru	2,579	3,467	5,425	6,188	5,165	7,062	7,518	11,840	9,161
Pacific Alliance Total	31,364	29,371	45,234	48,193	22,992	24,028	26,802	29,848	56,571
LAC	57,681	33,324	93,698	100,909	69,738	83,009	127,099	132,234	157,548

Source: Database from CEPALSTAT

FIGURE 3.2 Net Inflows of Foreign Direct Investment



Source: Database from CEPALSTAT

TABLE 3.4 FDI in the Pacific Alliance, 2013
(as a percentage of GDP)

Sector	Chile	Colombia	Mexico	Peru
Agriculture and food industry	0.01	0.08	0.01	0
Mining related activities	0.8	0.78	0.33	2.25
Energy extraction and production	1.75	1.44	0	0.62
Greenfield FDI	**2.56**	**2.3**	**0.34**	**2.87**
Others	3.93	1.94	3	1.72
TOTAL	**6.49**	**4.24**	**3.34**	**4.59**

Source: IDB 2015

The Role of SMEs

More than 99% of firms in Pacific Alliance countries are micro, small and medium-size enterprises (SMEs). They are also responsible for 67% of employment (OECD, 2013, p.17). This underlines the importance of SMEs in overall economic performance and their potential as agents of structural change and economic growth. Because a large segment of the population and of industries are directly linked to them, any industrial policy and structural change must take into account the variety of characteristics, peculiarities and dynamics of SMEs.

Despite their importance to employment, SMEs are only responsible for producing 30% of the GDP in the LAC area (OECD, 2013, p.44). As identified in the OECD's *Latin American Economic Outlook 2013*, in all countries in the region, SMEs operate in the least productive sectors of the economy, with little need and few incentives to work in conjunction with other firms, to create networks or clusters. As a result, they also have less chance of generating externalities to increase their specialization (and that of the workforce), their propensity to innovate and their productivity. The productivity of small firms relative to large firms in Latin America ranges from 16% to 36%, compared with 63% to 75% in Europe (OECD, 2013, p.46).

Similar gaps in productivity exist among segments of enterprises and sectors in members of the Pacific Alliance. For example, Chilean large companies reach levels of productivity which are as much as 33 times greater than those of microenterprises (in the case of Mexico, 6 times; Peru, 17 times; versus 2.4 times in OECD countries) and up to 4 times more productive than small firms (in Mexico this stands at 3 times, in Peru at 6 times compared to 1.6 times in OECD countries) (OECD, 2013). The low productivity of SMEs drags down these countries' potential for growth, increases the wage gap and may reinforce other forms of inequality pertaining to skills development, access to networks and adoption of new technologies.

TABLE 3.5 Proportion of firms by size in Pacific Alliance Countries
(Percentage)

Country	Micro	Small	Medium	Large
Chile	90.4	7.8	1.2	0.6
Colombia	93.2	5.5	1.0	0.3
Mexico	95.5	3.6	0.8	0.2
Peru	98.1	1.54	0.34	0.02

Source: OECD (2013)

Compared to other regions, SMEs in LAC countries experience multiple impediments to growth. Access to finance is generally constrained, and SMEs pay higher costs than large firms. LAC SMEs receive only 12% of total credit offered in the region, as compared to 25% in OECD countries. The cost of long-term financing is also more expensive although the ongoing evolution of the banking sector has lowered the net interest margins to 8.6% (a sharp contrast with the OECD average of 2.7%) (OECD, 2013, p.19). The World Bank's 2015 *Doing Business Survey* report ranks Colombia second in the Getting Credit category. While Mexico (12th) and Peru (12th) are ranked relatively high in this category, Chile's rank (71) is extremely low. A lack of skills and education emerges as one of main areas which need special attention. The Latin American Economic Outlook 2013 states that "almost 37% of companies in the region believe finding a workforce with the right skills is one of their main obstacles, a figure that is higher than the global average and the average for other developing regions."

Another aspect of the productive environment of Latin American SMEs is its low level of globalisation. For instance, while only around 10% of Latin American SMEs engage in export activities, 40% of European SMEs do so (OECD, 2013, p. 17). The degree and type of participation by Pacific Alliance countries in GVCs is diverse. According to the OECD-WTO Trade in Value added (TiVA) database, Mexico's backward GVC participation ratio (proportion of foreign value-added in its exports) is relatively high and growing (26% in 1995 to 30% in 2009). Its sales to other countries' value chains, i.e. the domestic value added in the exports of other countries as a share of its gross exports, or forward GVC participation ratio, grew only one percentage point from 10% in 1995 to 11% in 2009. This can be partially explained by Mexican

export industries' role as a leading assembler in global production networks, especially in sectors such as 'electrical and optical equipment' and 'transport equipment.' Chile, on the other hand has a lower, albeit growing, foreign value added content embodied in its exports (15% in 1995 to 18% in 2009) but its forward GVC participation shows a much more prominent and growing pattern (22% in 1995 to 33% in 2009). Colombia and Peru's economic structure and trade specialisation are closer to those of Chile than they are to those of Mexico. Estimations of the participation ratio for Colombia and Peru show backward ratios in 2005 at 16% and 10% respectively, and their forward participation ratios at 18% and 16% respectively.[9]

The integration of production clusters into GVCs presents both opportunities and challenges for SMEs. Integration of SMEs into GVCs is one way of upgrading their participation in the dynamic processes of production. This may provide SMEs with enhanced access to new export markets, helping SMEs to create new jobs and acquire new technological capacities in accordance with international best practices, thereby strengthening competitiveness. However, this integration into GVCs also presents challenges. The distributional effects and spillovers to domestic economies are not guaranteed. Whether SMEs seek to improve their product, production process or function in the chain depends on several factors, such as governance of the chain and the specific characteristics of the sector (OECD, 2013).

Overall, SMEs in most Latin American countries, including Pacific Alliance members, have substantial room for improvement, and face specific challenges and policy implications.

4. Policy Challenges and OECD Recommendations

Conditions for Successful Regional Integration

Regional economic integration has been a fundamental policy instrument of rapid economic growth in Pacific Alliance member countries. In principle, improved resource allocation will follow thanks to better access to technologies, inputs and intermediate goods. Trade liberalisation and economic integration contribute to optimise economies of scale and scope; greater domestic

9. This estimation for Peru and Colombia is based on the EORA database.

competition; and the availability of favourable growth externalities such as the transfer of knowledge.

At the same, the following considerations should be taken into account:

First, any regional trade arrangement should have very clear shared objectives related to market driven integration which seems to be the case in the Pacific Alliance context. These countries have strengthened their commitment to an outward-looking strategy for development, and therefore, a commitment to openness. Second, the size of the regional arrangement in terms of economy and population is another critical condition for the sustainability and success of economic integration. Regional arrangements with sufficient market size may be able to exercise leverage in shaping the regional and/or global economic order. The consolidated size of the Pacific Alliance's economy, will have a combined GDP of around US $3 trillion, which will bring them closer to be the seventh largest economy in the world.

Third, the political stability of members, a strong political will to reform, a pragmatic route to economic integration, members' engagement and commitment in regional economic cooperation, as well as global forum and trade negotiations (OECD: Chile and Mexico; Pacific APEC and TPP: Chile, Mexico and Peru) and, of course, relative homogeneity in language are strong binding forces to ensure the successful implementation of the agreement.

Policy Challenges

Since its creation, the Pacific Alliance has made notable progress in the area of policy coordination and cooperation to promote deeper economic integration. In the pursuit of its objective of deeper integration, however, the Pacific Alliance faces diverse challenges to sustaining the momentum of market-driven integration.

First, the intra-regional economic dependence of Pacific Alliance members is low and the intra-regional production network is relatively weak compared to other regional groups such as NAFTA, the EU and APEC. The role of a trade agreement in promoting regional growth and development derives from growing intra-regional economic interdependence. We can learn this lesson from APEC, NAFTA and the EU. For example, the strong interdependence among Pacific APEC member economies in terms of intra-regional trade share is one of the most promising factors. According to analysis, the share of intra-regional exports (imports) for Pacific APEC changed from 74% (71%)

in 2005 to 71% (67%) in 2013, while that of the EU decreased from 67% to 64%. In the case of NAFTA, the intra-regional export share stayed mostly the same at around 35% during this period.[10] Although the EU and Pacific APEC have experienced a slight decline of their intra-regional trade share for the period compared, they have maintained very high trade dependency. This will produce significant efficiency gains for the EU, NAFTA and Pacific APEC's objective of deepening market-driven economic integration in the region.

As mentioned above, intra-regional dependency among Pacific Alliance members is low (Table 3.2, Figure 3.1, Figure 4.1). In order for members to take advantage of their complementarities and economies of scale, Chile, Colombia and Peru need to diversify their export structure. Their major trading partners are countries in the Asia Pacific region. Although China has emerged as one of the most significant trading partners, supply chains that link Asian countries to its members barely exist, except in some labour intensive products and natural resources. It might be argued that economic activity among members needs large space in which to expand. In order to explore this possibility, SELA (2013) undertook a comparative review of the FTA's chapters in force among the members and revealed that significant barriers remain, mainly attributed to bilateral sensitivities and different priorities in trade and investment policy (SELA, 2013).

Second, each member maintains a unique investment linkage and concentration which is not mutually reinforcing. Inflows of FDI have escalated in the Pacific Alliance member countries, though in somewhat different manners and concentrations. In the case of Mexico, the so-called 'maquila' industry is characterised by "vertical MNEs" that import intermediate goods for production and export a large share of their production, taking advantage not only of the close distance to the US market and lower labour costs, but also, increasingly, the qualifications and experience accumulated in the manufacturing labour force. In the cases of Chile, Colombia and Peru, it is worth noting the sectors to which FDI is directed. The most prevalent pattern in these members is that of "Greenfield FDI," which is oriented to developing natural resource deposits. This brings capital and expertise to the country and develops forward GVC linkages, usually by exporting extracted raw materials, which are often processed elsewhere. More importantly, this unique feature of FDI concentration on natural resources makes these countries overly vulnerable to world

10. Own calculation based on online IMF DOTS database retrieved at http://elibrary-data.imf.org/QueryBuilder.aspx?key=19784661&s=322

commodity price shocks. This finding highlights the importance of recognising the heterogeneity in the degree and type of engagement of Pacific Alliance countries in GVCs, as well as the growing importance of GVC participation, both for sales and purchases of value added.

Third, infrastructure needs to be improved. As former Peruvian foreign minister Jose Garcia Belaunde stated, the Pacific Alliance is "based on affinity rather than proximity." Overall, in Latin America, infrastructure investment is less than 3% of GDP, while it should be at least 5.2% to close the gap with the levels prevailing in Asia. The IADB estimates that infrastructure investment should reach US$250 billion annually (IADB, 2013). There is a general consensus that the stable and cost-effective provision of energy and telecommunications is essential to expand the production possibilities of firms. The benefits of more and better roads, ports and railroads in reducing transportation costs and increasing the competitiveness of domestic firms are also well documented, including in the OECD's Latin American Economic Outlook 2014. Better logistics would result in a 35% growth in labour productivity, and even more when combined with better public services. While insufficient and low-quality transport infrastructure is the main factor behind poor logistics performance, some "soft" solutions could considerably reduce transport costs. The "hard" components are associated with physical infrastructure which, given the huge costs involved, are difficult to overhaul in the short run. It is therefore necessary to accompany measures aimed at modernising "hard" components with "soft" improvements such as improving governance to ensure a smooth integration of logistics policy, modern storage facilities, more efficient customs and certification procedures and mainstreaming the use of ICTs in existing transport infrastructure. Furthermore, generalised access to infrastructure services, from water and sanitation, to transport infrastructure and telecommunications, plays a key role in fighting poverty and reducing social exclusion and income inequality. At the same time, the development of infrastructure must be done in as far as possible an environmentally-friendly manner, avoiding worsening pollution problems in urban areas and supporting the transition to a low-carbon economy.

Fourth, a number of additional and imminent challenges that SMEs face are identified in the areas of innovation, compliance with standards, uneven bargaining power, lack of capacity and resources, skills, and information gaps. While some of the challenges related to these disparities are ones that SMEs routinely face, others are of greater importance to the LAC region. Both types of challenges are outlined as follows:

1) Previous OECD work has found that the use of ICT-technologies and related services play an important role in facilitating small firms' access to foreign markets, as it allows them to extend their network of business partners and reach new customers with greater ease and at lower costs (OECD, 2008). However, the low levels of penetration of fixed broadband access in the region and in particular, the low level of adoption of technology among SMEs, limits their capacity to grow and expand market opportunities,

2) LAC SMEs receive only 12% of total credit in the region, as compared to 25% in OECD countries (OECD, 2013). Long-term financing is also more expensive for SMEs in the region, particularly due to the ongoing transition of the banking sector. Table 4.1 displays data from the "Getting Credit" section of the World Bank's latest *Doing Business* Survey. Colombia emerges as a clear leader in terms of getting credit, ranked first in the LAC region, and an impressive second in the world overall. While Peru and Mexico also rank relatively high both in the LAC region and overall, Chile has a comparatively poor performance, with extremely low credit bureau coverage as compared to its fellow Pacific Alliance members, the LAC regional average, and OECD country average. Colombia's high Getting Credit rank demonstrates the importance of strong institutions and, especially, solid collateral and bankruptcy laws protecting the rights of borrowers and lenders and thus facilitating lending,

3) LAC SMEs have important skills gaps. Almost 37% of companies in the region believe that finding a workforce with the necessary training is one of their main obstacles, which is higher than both the global average and figures for other developing regions (OECD, 2013),

4) The length and costs of processes to both start and close a business are important considerations for the SME sector (OECD, 2013). Lengthy processes and high costs during start-up encourage SMEs to operate informally, further restricting them from access to assistance and finance by formal and governmental institutions, and from the ability to join GVCs. On the other hand, lack of an appropriate framework to close-down companies imposes creditors to significant risk, making them potentially less likely to invest in new, smaller businesses,

5) The productive structure prevalent in LAC countries often poses barriers to SME productivity and internationalisation. The regional export structure does not encourage SMEs to access more innovative processes through a stimulus to export, as it is centred on natural resources and their derivatives and dominated by large firms due to the heavy investment costs in these sectors (OECD, 2013). This productive structure limits the ability of SMEs in LAC

to link with larger firms, since rather than complementing their production, they attempt to compete with them. The particularly low rates of productivity in LAC SMEs also impacts their ability to link with MNEs, as large firms are not apt to choose suppliers who will struggle to meet the necessary quality standards or volume of production. This results in a vicious cycle, with the SMEs' initial low productivity fuelling an absence of knowledge transfer among businesses, and vice versa (OECD, 2013).

TABLE 4.1 Indicators for obtaining credit in 2014, Pacific Alliance Countries, LAC Region, and OECD countries

Country	Getting Credit Rank (Overall)	Getting Credit Rank (LAC Region)	Strength of legal rights index (0-12)	Depth of credit information index (0-8)	Credit registry coverage (% of adults)	Credit bureau coverage (% of adults)
Chile	71	11	4	6	44.7	8.8
Colombia	2	1	12	7	0.0	87.0
Mexico	12	4	8	8	0.0	100.0
Peru	12	4	8	8	33.5	100.0
LAC Region	-	-	4.8	4.6	12.6	39.3
OECD countries	-	-	5.8	6.5	12.1	67.0

Source: World Bank Doing Business Survey (http://www.doingbusiness.org)

Policy Implications and Recommendations

These challenges carry implications and invite targeted recommendations from the OECD:

First, economic integration will be more successful if the Pacific Alliance takes more proactive and holistic approaches to reform in cross-border, on-the-border and behind-the-border areas. Analysis also evidences the need for wider structural reform. Region-wide confidence in the merits of openness made it possible to endorse the Framework Agreement. However, border protection of sensitive products remains high and the goal of eliminating border barriers may be out of reach in some sectors. Although leaders of the Pacific Alliance agree on eliminating substantial tariffs, the impact will be very limited unless

a broad and comprehensive reform agenda is supported. Cutting red tape can serve to reduce transaction costs, but it also keeps raising new issues to be dealt with. It is therefore realistic to expect that all Pacific Alliance members will collectively move towards strengthening the rule of law and good governance as fast as they can. However, it is not realistic to expect them to proceed at the same pace. A more practical strategy might be to encourage all Pacific Alliance member countries to set their own timetables for progress.

Second, progress towards a more integrated economic environment in the 21st century could be achieved by strengthening institutional capacity and skills. The Framework Agenda has provided the Pacific Alliance with a strong sense of direction. At the same time, the challenges associated with fulfilling the Pacific Alliance's strategic goal will become increasingly complex, in the context of low growth and weak external demand. Global challenges like climate change will require different policy options in the map for economic integration. To approach free and open trade and investment more effectively, Pacific Alliance members will need to tackle many of the issues addressed by concluded NAFTA provisions, an evolving APEC agenda and ongoing TPP negotiations, but they will need to do so in a more innovative and targeted manner.

Third, it would be preferable for the Pacific Alliance to identify practical steps to better facilitate integration into Global Value Chains (GVCs). GVCs have become a dominant feature of world trade and investment, offering new prospects for growth, development and employment. The low level of current regional GVC integration, coupled with the possible complementarities arising from differing specialisations along specific value chains and differing sector specialisations, suggests that there might be scope to increase the share of the Pacific Alliance's GVC participation. A key finding of OECD analysis to date is that GVCs do not respond to piecemeal approaches to policy change. A "whole-of-value-chain" approach is needed, including a focus on the role of efficient border measures that avoid imposing unnecessary costs on traders, access to world class services and knowledge inputs, flanking policies that improve supply capacity (skills development, physical infrastructure, technology, entrepreneurship, etc.), and social adjustment schemes. Investment in infrastructure and quality institutions is key for GVC expansion and the reduction of trade costs. Both uncertainty in international contracts and low quality infrastructure can lead to delays and sub-optimal outcomes in terms of trade and investment (OECD, 2014).

Fourth, it may be useful to catalyse the resources needed for mutually beneficial economic integration from the government and private sector. There is a consensus that private participation is not a panacea. Latin America has been at the forefront of Private-Public Partnerships (PPPs). One of the key challenges for governments has been to balance the sharing of risks and returns between the government and its private sector partners, while at the same time dealing with the technical complexities of projects. Success requires that governments invest heavily in high quality pre-construction studies and surveys, that they structure contracts carefully to achieve an appropriate distribution of risks and expected rewards, and that the mix of private-public investment and involvement be adapted to specific circumstances. Long-Term Investors (LTIs) such as Sovereign Wealth Funds, mutual and pension funds are also emerging as a powerful force in the global economy. They currently invest only 1% of their assets in infrastructure, and a marginal share in green technologies, so there are great opportunities. But to be attractive to investors, infrastructure projects must be bankable with a fair and transparent regulatory regime.

Finally, in-depth analysis of SME bottlenecks would provide a useful reference point for policies to revive entrepreneurial dynamics that are crucial for a job-rich recovery and sustained growth. While clearly highly important in terms of number and employment generation, the productivity gap between SMEs and large firms is a crucial limitation for stronger and more inclusive growth in Latin American countries in general and Pacific Alliance countries in particular. A key policy objective therefore is increasing productivity of the large number of SMEs in Pacific Alliance countries. Latin American SMEs are highly heterogeneous, ranging from sole traders running informal microenterprises to highly efficient innovative companies with the capacity to export products. If a set of coherent, coordinated policies is introduced, SMEs could contribute to structural change by helping to improve productivity, complementing the economies of scale by large firms driving the creation of production clusters (OECD, 2013). The ability of SMEs to take advantage of GVCs is further constrained by limited access to finance, inefficient infrastructure, limited human capital, and weak local industry networks. These problems affect developing countries even more acutely than developed ones. The ability to comply with international standards is an especially important constraint on firms that have previously been strictly domestic. Taking into account the difficulties faced by SMEs, the following three policy areas are suggested for Pacific Alliance member countries to design corresponding

policy frameworks and institutions: (i) Promoting SME access to finance, (ii) Promoting skills in the SME workforce, and (iii) Improving participation of SMEs in the tourism sector.

The Pacific Alliance and the OECD: Prospects for Cooperation

The unilateral and bilateral liberalisation implemented by Pacific Alliance members over the past years has significantly contributed to the expansion of their trade, investment and growth. The Pacific Alliance's own collective reform process will have a spillover effect, encouraging other countries to liberalise their economies further. However, many issues need to be addressed, and there are many challenges to overcome. To sustain the political support and to mobilize the resources needed to implement the Framework Agenda, it will be important to generate confidence that these efforts will result in significant improvements in the living standards of the population. This will require members to take proactive approaches towards comprehensive reform. Pacific Alliance initiatives strive to go beyond eliminating tariffs to tackle costly "behind the border" barriers that impede the flow of trade and investment. Looking ahead, the Pacific Alliance needs to remain ambitious, but also realistic. It could take advantage of pragmatic cooperation processes and learn to complement other institutions.

Promoting further and deeper dialogue and exchange of expertise could reduce risk perception, and the OECD stands ready to work with Pacific Alliance towards that end.

To deal with complicated initiatives, working groups have been established: these include (1) Trade and Integration,[11] (2) Services and Capital, (3) Movement of People, (4) Cooperation, (5) Institutional Affairs, (6) SMEs, (7) Foreign Relations, and (8) Committee of Experts (linked to the Business Council of the Pacific Alliance). An effective way to approach the OECD's co-operation with the Pacific Alliance would be to engage with expert advice in each of these groups (similarly to the way the OECD engages with working groups of other mechanisms of co-operation such as the G20 or B20). In the domain of trade, investment and SMEs, examples of potential areas of co-operation with OECD could be illustrated as follows:

11. Chapters on Access to Markets and Rules of Origin, Trade Facilitation, Customs Cooperation, Technical Barriers to Trade and Sanitary Measures were negotiated to regulate and facilitate trade in goods between the signatory countries. Source: http://alianzapacifico.net/en/trade-and-integration-group/

Trade and Integration

The OECD's work on 'Trade in Value Added (TiVA)' and Trade Facilitation would be useful as a follow up to the work of the Trade and Integration group. The OECD is in the process of updating and expanding the OECD-WTO TiVA database to include 62 countries and 34 sectors. Databases for Chile, Colombia and Mexico are already available, while the one on Peru is in progress. The Pacific Alliance should defend the integrity of the non-discriminatory WTO-based multilateral trading system. The OECD has also shared with the WTO an analysis of more than 250 signed RTAs, highlighting provisions that go beyond existing multilateral commitments. By understanding the nature of these WTO-plus commitments, the OECD can explore, from a technical perspective, whether RTAs could be used as "stepping stones" towards further market opening on a multilateral level. The OECD is also working to develop a quantitative assessment of the economic effects of 250 policy measures –that are likely to have the greatest impact on trade– introduced since 2008, drawing from Annex 3 of the WTO report on trade protectionism.[12]

Service and Capital

The mandate of the 'Service and Capital Group' is to position Pacific Alliance member countries as an attractive destination for investment and trade in services. Global flows of foreign direct investment remain 40% below the peak levels reached in 2007. The OECD considers FDI to be a critical ingredient for growth. The OECD updated its Policy Framework for Investment (PFI) in June 2015. The objective of the PFI is to mobilize private investment that supports steady economic growth and sustainable development. It provides a checklist of key policy issues for consideration by any government interested in creating an enabling environment for all types of investment and in enhancing the development benefits of investment to society. For instance, infrastructure investment is very risky, when regulatory regimes are neither transparent nor predictable.

12. These instruments affect nearly every economic sector. We have calculated 1,663 instances of economic sectors being affected by an instrument; 60% of those are concentrated in five sectors: machinery and equipment; textiles; wearing apparel; chemical, rubber, and plastic products; and other food products. There is much to be said, also, about actions that are not duly notified.

FDI Patterns of value added trade in GVCs are shaped to a significant extent by the investment decisions of Multinational Enterprises (MNEs) and all four member countries are adherents to the OECD Guidelines for MNEs. The Guidelines are widely used as the most comprehensive tool to help businesses meet the challenge of acting responsibly in any country in which they operate by providing a global framework for responsible conduct covering all areas of business ethics.

A meeting of the Latin America and Caribbean-OECD Investment Initiative took place in Lima, Peru, in July 2014, and provided a good opportunity to foster cooperation with the Pacific Alliance. The meeting focused on infrastructure investment and how successful infrastructure programmes depend on good governance. It is essential to develop an integrated approach to infrastructure governance to deliver the right strategic infrastructure on time, within budget and in a manner that commands the confidence of all stakeholders.

The OECD stands ready to cooperate with Pacific Alliance member countries to render infrastructure markets more attractive for private investors, thus promoting high impact investment with limited public resources. Our G20/OECD Principles on Long-Term Investment could offer additional support to that end.[13]

The OECD is also supporting the group on issues of fiscal transparency and exchange of information, helping to establish mechanisms for exchange of information among Pacific Alliance member countries, including under the latest OECD initiative on automatic exchange of information. Colombia, Mexico and Chile are already signatories of the Multilateral Convention on Mutual Administrative Assistance on Tax Matters. And all four members are adherents to the Global Forum on Transparency and Exchange of Information for Tax Purposes. All four countries also participate directly in the OECD's Base Erosion and Profit Shifting (BEPS) Project. BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to locations where there is little or no economic activity or value creation. The OECD/G20 BEPS Project was launched in July 2013, based on an Action Plan which identified 15 action items, to be addressed and delivered

13. G20/OECD High-Level Principles for Long-Term Investment were endorsed by G20 Leaders in 2013. These high-level principles are intended to help governments facilitate and promote long-term investment by institutional investors, particularly among institutions such as pension funds, insurers and sovereign wealth funds, which typically have long duration liabilities and, consequently, can consider investments over a long period. Currently, OECD work aims to identify approaches to their implementation.

by October 2015. Mexico and Chile participate as OECD members in the BEPS Project. Colombia, which has started the OECD accession process is an Associate to the Project and Peru, participates directly as one of 14 developing countries in the Committee on Fiscal Affairs and the Working Party meetings on the BEPS Project. This direct engagement is part of the OECD's strategy to strengthen the direct engagement of developing countries.

SMEs

There have been conversations within the framework of the LAC Investment Initiative of Pursuing a Project on SMEs for the Pacific Alliance. The OECD has been collaborating with the SME group to identify policy options and construct a joint agenda that could help SMEs take advantage of the Pacific Alliance's market integration. Pacific Alliance member countries have benefited significantly from in-depth analysis of the SME sector by the OECD (OECD, 2013). The OECD Scoreboard on Financing SMEs and Entrepreneurs, published annually, provides governments with the necessary information on the state of play with regard to their SMEs' access to finance and current obstacles they face. The OECD's ongoing work on SMEs also aims at understanding the factors at play behind various obstacles. This will allow policymakers to see more clearly that direct exports by SMEs are only part of the GVC integration story. The OECD is indeed looking into the contribution of SMEs as suppliers to the larger firms that are often dominant in GVCs. Barriers that deter entry into GVCs are harder to identify within international monitoring exercises, and greater effort is required in understanding and addressing these measures.[14] There have been exploratory talks with the OECD and the members of the Pacific Alliance's SME Working Group about developing a Pacific Alliance version of the SME Policy Index. This index would contribute to track SME policy developments across the region and foster policy cooperation and convergence towards good practices.[15]

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14. The monitoring exercise would also rely on the annual OECD report on *Financing SMEs and Entrepreneurs: An OECD Scoreboard.* This report presents the latest trends in SME access to finance and recent policy initiatives to support SME finance. The 2015 report covers 34 countries, of which 11 G20 countries. It is proposed to extend coverage to the remaining eight G20 countries, in order to offer the G20 a state-of-the-art tool to monitor SME finance.

15. The SME Policy Index is an analytical tool elaborated by the OECD in consultation with the European Commission and other international organisation (EBRD, EIB and ETF) to track SME policy

Other Relevant Areas

The constraint on more rapid progress is not only political resistance but also limits the capacity to design and implement the policy reforms needed to cut transaction costs. All Pacific Alliance countries participate in the OECD's Programme for International Student Assessment (PISA) and could take advantage of this instrument to identify areas of quality and equity improvement in their education systems. The OECD's work on migration, including the International Migration Outlook and the experience in the region with the SICREMI report could also be of interest to the working group, 'Movement of Business People and Facilitation of Migration Transit.'

The OECD Development Centre supports policy dialogue and reform efforts in Latin America and in the members of the Pacific Alliance through the annual Latin American Economic Outlook (LEO), which is presented with its findings and recommendations annually at the Ibero-American Summit. In 2015 the LEO focuses on education and skills in Latin America and can serve as a good basis for reform efforts in the areas of skills and inclusive growth. Reforms to strengthen education, skills and innovation will foster higher growth potential and higher productivity, and must ensure equal opportunities in access to high quality training. This is vital: currently, Latin American firms in the formal economy are 3 times more likely than South Asian firms and 13 times more likely than Pacific-Asian firms to face serious operational problems due to a shortage of human capital (OECD:2015c). This problem is compounded by the high informality among workers and in the business community. The OECD is committed to supporting the region promote inclusive growth and improve the productive capacities of the economy.

The OECD also has a Latin America and the Caribbean Comprehensive Regional Programme. This Programme will allow for a strategic, horizontal, whole-of-government framework for interaction to support the region's key priorities, such as increasing productivity, reducing inequality, strengthening institutions and improving sustainability, with well-being as the convergence point for all four priorities. This will build on the OECD's already active

development across a number of policy dimensions (from institutional development to skill development, access to finance, support to start up, service provision, internationalisation, etc.), across countries and time through a set of qualitative and quantitative indicators. It has already been applied to four regions: South East Europe and Turkey, Mediterranean North Africa and Middle East, Eastern Partnership countries (Ukraine, Moldova, Belarus, Armenia, Azerbaijan and Georgia) and ASEAN for a total of 32 countries. So far, seven regional reports have already been published, while other two reports are currently in preparation.

engagement with the region through the Summits of the Pacific Alliance and the Ibero-American Summit, which it also supports as an active advisory observer.

5. Summary and Conclusion

The leaders of Chile, Colombia, Mexico and Peru have come together to reinforce trade and investment as the main engine of growth and development. The formation of a Pacific Alliance presents challenges, but also an opportunity for reform in member countries. As the overriding interest of member countries in a rules-based system is reflected in the objectives of the Pacific Alliance, the positive gains from regional-integration are expected to be significant enough to produce positive spillover effects in productivity and job creation. At the same time, however, the asymmetric economic structure and low intra-regional economic dependency could deter harmonious policy coordination. Poor physical infrastructure and shallow value chains are other key challenges that need to be overcome for efficient resource utilisation. In addition to these stumbling blocks, SMEs often face key challenges that disproportionately limit their participation in domestic, regional and global business activities. Some of these challenges are imposed by governments, such as compliance with a multitude of regulatory standards or the absence of essential public infrastructure, which SMEs do not always have the capabilities to overcome. Other challenges are set by lead firms – such as cost, lead-time, and batch size. The focus now should be to build capacity to deal with such challenges with an appropriate policy injection that can be conducive to more market-driven integration.

With a view to providing opportunities for Pacific Alliance policymakers to respond to such challenges, the following five policy suggestions are illustrated: 1) take a holistic approach to reform in the area of cross-border, on-the-border and behind-the-border issues; 2) build institutional capacity and skills to deal with newly emerging 21st century issues; 3) identify practical steps to better integrate into GVCs; 4) amplify collective efforts to build the necessary human infrastructural capacity; and 5) find practical ways (including in-depth analysis of SMEs' bottlenecks) to revive entrepreneurial dynamics. Successful application should be in accordance with the Pacific Alliance's ongoing structural adjustment to promote mutually beneficial economic integration. A strategy for the Pacific Alliance process needs to be consistent with the

strategic context and purpose of their unilateral, bilateral, regional and multilateral commitments. It needs to take advantage of experience in APEC and ongoing TPP negotiation. Therefore, if the Pacific Alliance could be linked to current initiatives on 'trade, investment and service liberalisation and facilitation' and 'rule-making and standard-setting' processes in APEC and TPP negotiations, the member countries may be able to enjoy significant economic gains from economic integration without having to pay an extra policy cost.

One of the biggest constraints on progress towards structural adjustment and cooperative arrangements to move in this direction is largely a matter of sharing information, experience, expertise and knowledge. This kind of cooperation is in line with the comparative advantage of the OECD in its capacity as 'Global Think and Do Tank.' Especially considering the challenges lying ahead, the OECD's tailored policy suggestions, instruments, measures and initiatives are well placed to make a positive contribution to the process. By taking part in the OECD's bodies and instruments, as members (Chile and Mexico), accession countries (Colombia),[16] and Peru (OECD Country Programme) can both increase their collaboration with the Organisation and its members and make use of policy advice which can lead to more inclusive and sustainable growth in the OECD, in the Pacific Alliance and in Latin America more generally.

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CHILE AND THE PACIFIC ALLIANCE

Edgardo Riveros and Carmen Domínguez

Introduction

Chile, Colombia, Mexico and Peru have accomplished much since the launch of the Pacific Alliance in April 2011. Important agreements have been signed, ratified and are in the process of being implemented; there are numerous working groups and task forces not only accomplishing their mandates but adding new tasks to their agendas. More than 40 countries have signed on as observers, and new partnerships with other regional groupings are being pursued.

After the Presidential Summit in Paracas, Peru in early July 2015, the four countries appear to be entering a new stage; one in which not only will there be a push toward increasing intra-regional trade –today only around 4% of the total exports of the Pacific Alliance members go to each other's markets[1]– through the freer movement of goods, services, capital and people, but there is also a growing need to more clearly define the role of observer states and to promote closer ties to other regional blocs and regions, particularly in the Asia Pacific region.

This essay will attempt to address the following issues: the high priority Chile assigns to regional integration; the importance of the Pacific Alliance in this regard; a balance of the first stage of the process; the relation between the Pacific Alliance and other regional integration initiatives, in particular Chile's proposal for "convergence in diversity," the Asia Pacific region and its significance for Chile, and the tasks and challenges the Pacific Alliance faces as it matures. This, with a view toward mid-2016, when Chile will take over as the Pro Tempore Presidency of the Alliance.

1. Sebastian Herreros (2014) La Alianza del Pacífico y el MERCOSUR: hacia la convergencia en la diversidad (ECLAC (2014) LC/L.3922), p. 41.

Why regional integration?

Chile has been committed to regional integration since the 1960s, when it signed the Treaty of Montevideo, which established the Latin American Free Trade Association (LAFTA), later replaced by the Latin American Integration Association or LAIA (1980). It was also an original member of the Andean Pact (today the Andean Community), founded in 1969 by Bolivia, Chile, Colombia, Ecuador, and Peru (Chile withdrew in 1976 and rejoined as an associate in 2006). Both initiatives were backed decisively by Chile, which perceived these early attempts at economic integration among Latin American countries, as a path toward stability, growth and development for the region.

Since then, and particularly from the return to democracy in the nineties, Chile has been an active proponent of and participant in of many of the political and economic integration schemes in the region. Today, in the political arena, Chile participates both in the Community of Latin American and Caribbean States (CELAC), as well as in the Union of South American Nations (UNASUR).

In the area of regional economic integration, Chile's efforts are currently centered on the Pacific Alliance. Nonetheless, Chile as an associate member of MERCOSUR, is an advocate for "convergence in diversity," or finding areas of common interest between Pacific Alliance and MERCOSUR countries with which to build closer ties, increase intraregional trade and investment and multiply the potential to interact with the emerging markets of Asia Pacific. In parallel, Chile continues to participate in APEC and to seek closer relations with other regional groupings, such as the Association of Southeast Asian Nations (ASEAN), the Central American Integration System (SICA) and the European Union.

As a medium size country and a close spectator of the European Union, Chile, like many Latin American countries, has long been aware of the benefits that integration among countries can bring, not only in terms of economic growth, but also in political and social development. Today, the importance of regional integration cannot be underestimated, particularly in the case of a Chile, a country fully integrated into the global economy, with 24 Free Trade Agreements with 63 countries, representing 63.3% of the global population and 83.3% of the world GDP.[2] In parallel to its activities within the region, Chile is actively participating in the Trans Pacific Partnership (TPP) negotia-

2. www.direcon.gob.cl.

tions, defining the terms for the modernization of the Association Agreement with the European Union and looking toward Euroasia and Africa for new markets.

As ECLAC[3] and others have stated, Latin America faces a number of challenges in today's changing economic environment. These include the emergence of a new economic global center in Asia Pacific, a global economy unable to recover the dynamism prior to the 2008-2009 financial crisis, financial volatility, stagnant growth in the developed economies of the Eurozone and Japan, with only the United States showing some positive signs. China is no longer growing at the rate it did during the last decade; in fact, according to the Asian Development Bank (ADB), China's economy in 2014 grew 7.4 percent, which is its weakest annual expansion in 24 years. GDP growth in the first quarter of 2015 eased to 7 percent.[4] The commodity booms that contributed to the steady economic growth of Latin American countries, including Chile, appear to have become a thing of the past, while there is less access to financing and an ever increasing need, and demand for, greater infrastructure, innovation, technology and better public services from citizens and both the private and public sectors.

A result of this situation was the downward revision of their projection in April 2015 by ECLAC of its economic growth outlook for Latin America and the Caribbean for 2015. It forecast a 1.0% increase in the regional Gross Domestic Product (GDP), while sub-regionally, the international organization forecast growth of nearly zero for South America, with Central America and Mexico reaching 3.2% and the Caribbean 1.9%.[5] Closer to home, according to the latest figures of ECLAC, OECD and the IMF, Chile's economic growth in 2015 should be around 2.5%.[6]

In this challenging world, blocs of countries or regional groupings increasingly interact and negotiate, as can be seen with the TPP in the Pacific Rim or the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union. For Chile, integration cannot be just empty words and unfulfilled promises. It must be built on realistic

3. ECLAC (2014) Economic Survey of Latin America and the Caribbean 2014: Challenges to sustainable growth in a new external context, (LC/G.2619-P), Santiago, Chile.

4. www.adb.org/news/adb-sees-strong-growth-developing-asia-2015-and-2016.

5. http://www.cepal.org/en/pressreleases/economy-latin-america-and-caribbean-grow-around-1-2015-according-eclacs-latest

6. https://www.df.cl/noticias/economia-y-politica/actualidad/la-cepal-se-une-al-fmi-y-a-la-ocde-y-recorta-a-2-5-la-estimacion-de-crecimiento-de-chile-para-este-ano/2015-07-29/203904.html

commitments, action plans that lead to tangible results and be backed by the political will of all participants.

It may seem to some that the plethora of regional and sub-regional initiatives in Latin America and the Caribbean is akin to an alphabet soup without much substance; yet for Chile, both the political fora, such as CELAC and UNASUR and the economic integration blocs, like the Pacific Alliance or MERCOSUR, play an important role both in the region and internationally. They ensure that the demands and interests of Latin American and Caribbean countries are heard in international debates, including on issues such as climate change or the post 2015 development agenda.

Regionally, they can help build the capacity to create new opportunities to diversify our export offer both in goods and services, promote investment in diverse economic sectors, particularly small and medium enterprises and infrastructure, and integrate into global and regional value chains. There is ample space for more trade and investments within the region; as of 2015, only 17.5% of Chile's trade is carried out within the region (10.3% with MERCOSUR and 6.2% with Pacific Alliance), while 40.8% is with China.[7] Today, regional integration is not just another option, but rather a necessity for Chile.

Pacific Alliance – the First Stage

In 2011, the Presidents of Chile, Peru, Colombia and Mexico launched the Pacific Alliance. These four countries are generally seen as the most vibrant economies in Latin America, with open trade regimes, positive social indicators, solid macroeconomic indicators and relatively high growth rates.[8] The four countries have also signed numerous free trade agreements, including among themselves.

Although there was a formal predecessor to this initiative, the Pacific Basin, a strong impetus was provided by the joint decision of all four countries in that it was felt to be the time to deal with the growing economic challenges, and that the best way would be to orient their trade towards the dynamic markets of Asia Pacific. Despite Chile's close relations with many of the Asia Pacific markets, there was a realization that together with other like economies, it would be able to achieve much more than on its own.

7. www.direcon.gob.cl
8. http://www.economist.com/node/21631801.

The brevity and clarity of the initial joint statement of the Pacific Alliance signaled the desire for a new, more pragmatic regional initiative. The aim was, and is, to achieve "deep integration" of the four economies through the free movement of goods, services, capital and labor and, in parallel, to strengthen ties in general with the world and with Asia Pacific specifically. The four countries' ultimate objective is to achieve sustainable economic growth and competitiveness by increasing intra-regional and extra-regional growth.

Since then, the four countries have been moving beyond their FTAs on goods and services to the free circulation of goods, services, capital and people. Why? The four members believe that more growth, competitiveness and development of their economies will lead to greater well-being and social cohesion, as well as less inequality. In addition, the Pacific Alliance seeks to create an economic and trade base that can interact with other regions, particularly Asia Pacific. In this context, Chile's geographical position allows it to become both a bridge and a port to markets on both the Pacific and the Atlantic.

The Pacific Alliance is a dynamic and ambitious economic integration scheme, yet it also focuses on people and services. Together the Pacific Alliance members account for 3% of world GDP and per capita GDP (PPP) of over US$14000, 215 million consumers, 50% of Latin American trade worldwide and receive around 46% of FDI to the region.[9]

The Pacific Alliance is seen internationally as a serious initiative; one that currently has 42 observers, four of which (Costa Rica, Panama, Honduras and Guatemala) have signaled their interest in becoming full Members, while many others have expressed interest in collaborating with the Pacific Alliance in a myriad of areas. In parallel, the Alliance has also shown a clear vocation to advancing toward a convergence with all countries in the region. In addition, it works closely with the Inter-American Development Bank, the OECD and the CAF.

At the same time, the bloc represents a forum for cooperation between the region's public and private sectors. The Pacific Alliance Business Forum (CEAP) was created in August 2012 with the aim of contributing to the Alliance's integration process, facilitating member economies' regional

9. Herreros, The Pacific Alliance: A Bridge between Latin America and Asia Pacific, ISEAS Symposium on Regionalism in the Asia Pacific: Current and Future Developments, Singapore 21 August 2014. Http://www.iseas.edu.sg/ISEAS/upload/files/10_Herreros.pdf.

integration, and promoting greater growth, development, and competitiveness for the members' economies.

The CEAP supports the creation of a deep integration space attractive to investment and trade in the Pacific Alliance. In addition, the Forum promotes activities which seek to enable the Pacific Alliance to coordinate the private sector's efforts, focusing on innovation and production connections, so as to take advantage of opportunities offered by emerging markets in Asia and other continents. The Forum is integrated by representative chapters of each member country, which are led by top business leaders. Among other activities carried out by the Pacific Alliance with the private sector are the Macro Business Roundtables and Fora on Innovation and Entrepreneurship.

At the Fourth Summit in Paranal, Chile (June 2012), the Framework Agreement, a founding document for the Alliance, was signed. This accord states that the existing trade agreements between the member countries are the starting point for this initiative. In other words, future trade obligations will build upon existing ones and lead to more trade openness. It also defines the essential requirements of participation by Members, as well as the objectives of the Alliance, and the actions that must be undertaken to meet them. It further defines institutions, their powers and the mechanisms for adopting decisions, as well as the procedures for the participation of Observers and the accession of new Members.[10]

On July 20th, the Framework Agreement entered into force in the four countries. This formal step ensures that all the hard work of the last three years has a solid and lasting basis, as well as a establishing the legal framework for future actions.

In February 2014, the four countries signed the Trade Protocol to Framework Agreement, which will allow the Alliance to advance as a successful integration model, by establishing shared rules regarding goods, services and capital flows. This Protocol builds on, and updates, the existing FTAs between the Members, and is currently undergoing approval by the Chilean Congress and in the other three countries.

The Protocol is made up of 19 chapters, closely resembling the trade agreements signed by the countries with the United States,[11] but does not

10 http://www.sice.oas.org/TPD/Pacific_Alliance/Agreements/Framework_Agreement_Pacific_Alliance_s.pdf

11. *Ibid*. Herreros.

include chapters on intellectual property, trade remedies, competition policy, labor or the environment.

Among its main features are:

- Around 92% of all trade in goods is liberalized among the four upon entry into force, while the remaining 8% will be eliminated within 3 to 8 years.
- It includes trade liberalization in goods and services, government procurement, investment, e-commerce and telecom.
- Full accumulation of origin among the four Members.
- A Trade Facilitation chapter, which includes a single window system, which enables international (cross-border) traders to submit regulatory documents at a single location and/or single entity, thus reducing transaction costs.
- Dispute Settlement provisions.
- Government Procurement commitments for goods and services at central and sub-central levels.[12]

In parallel, work has continued on Innovation and Small and Medium Sized Enterprises (SMEs). With technical and financial assistance from the Inter-American Development Bank and the OECD, the four member countries are looking at adopting policies aimed at increasing the competitiveness and internationalization of SMEs, as well as the diversification of their exports and incorporation into global value chains.

The Pacific Alliance has made more progress, through more than a dozen Working Groups, such as the ones on Mining, Social Responsibility and Sustainability. Created at Chile's behest, they seek to promote knowledge sharing and capacity building in areas such as community participation, indigenous development, work safety, innovation, water resources and energy. It is Chile's wish that these Groups will contribute to the design of public policies in Member countries and promote the exchange of experiences in the areas of social responsibility and sustainability, not only within the Pacific Alliance, but with other countries in the region as well.

Regarding financial market integration, the stock markets of Chile, Colombia and Peru also agreed to join up in a regional bourse called Latin American Integrated Market, or MILA, which Mexico's exchange joined in 2014.

12. http://www.direcon.gob.cl/2014/02/protocolo-adicional-al-acuerdo-marco-alianza-del-pacifico-que-significa/

With the addition of Mexico, MILA has become the largest regional market in terms of capitalization ($1.1 billion) and number of companies (986) after the São Paulo-based stock exchange, BOVESPA. MILA offers investors access to investments in manufacturing, construction, and telecommunications in Mexico, retail in Chile, mining in Peru and oil and services in Colombia.[13]

Since its inception, the Pacific Alliance has also made progress on its second dimension, the movement of services and people. The four countries have scrapped tourist visa requirements for citizens of the bloc and have begun to open some shared embassies and trade promotion offices abroad. Scholarships are being provided to university students for exchange programs in other Member countries. There is also an agreement on working holidays in effect, which will promote cultural exchange among young people. The tourism sector has also benefited, as shown by the fact that the elimination of visas meant an increase of nearly 200,000 new visitors in 2013 to Mexico from the Pacific Alliance countries.[14]

Joint promotion projects have also been developed, which provide an opportunity for our countries to highlight a variety of areas, such as regional cuisines and crafts. There is also a new initiative for youth volunteers to work on social projects throughout the four countries. These events and activities confirm that there is an enormous potential to be explored in the Pacific Alliance.

The X Pacific Alliance Summit

At the Paracas Summit, in July 2015, Chile noted the importance of the Protocol to the Framework Agreement, as an incentive for intra-regional growth, while calling for further action, setting the bases for a deeper exchange with the Asia Pacific region. One such step is the First Protocol Modifying the Protocol to the Framework Agreement, which includes a chapter on regulatory improvements, an annex of Technical Barriers to Trade in the Cosmetics sector, as well as improvements and new norms for the telecommunications and e-commerce chapters of the Protocol Agreement.

The progress made in the 19 Technical Groups and four Task Forces was also noted, as were the new mandates for most of them. These include

13. http://www.as-coa.org/articles/summary-trade-integration-and-pacific-alliance.

14. *Pacific Alliance and Chile Vision* (2015) General Directorate of international Economic Affairs, Ministry of Foreign Affairs, Chile.

a foreign investment promotion policy, a regional investment fund, administrative norms homologation and the implementation of the Joint Cooperation Fund for the Pacific Alliance, among others.[15]

Chile also recognized the growing number of observer countries, as well as the strategic partnership reached with Canada and the proposal by New Zealand to substantively engage once the Pacific Alliance has consolidated its early gains. The presence of a number of Ministers from observer countries in Paracas can be viewed as a sign that the Alliance is seen as an innovative and serious initiative by many around the world. As a result of this development, there an agreement by the four countries to set up a task force to analyze the cooperation proposals made by the observer countries, and a response and action plan was prepared.

Another positive sign highlighted by Chile was the meeting between members of the Pacific Alliance and ASEAN on 25 May 2015, which sought to explore possible areas of cooperation that will build closer ties between the two regional organizations in areas such as trade and investment, agriculture, energy, logistics, SMEs, financial services and tourism. The two regional groupings also agreed to further explore other areas such as education, culture, and sports. With APEC, there are plans to hold a meeting during the Philippines APEC Summit in late 2015.

A sign of further progress was the creation of a working group which seeks to include a gender policy dimension in all work carried out by the Pacific Alliance. Chile foresaw that a part of its work will focus on micro, small and medium-sized enterprise, with a particular focus on businesses created by women entrepreneurs, where there are a number of discriminatory barriers, such as a lack of access to financing or legal hurdles that constrain their entry and participation in the formal economy. This is a shared challenge for all Pacific Alliance members and demands an identification of such barriers, as well as a plan of action to deal with them in an appropriate manner.

Financial integration is another area of high interest for both the public and private sectors of the four countries. At the June 26 and 27, 2015 meeting of the Finance Ministers of the Pacific Alliance, an agreement was reached on the importance of promoting infrastructure investments, since the current international economic situation has posed challenges to the traditional long-term financing players.

15. Idem. *Pacific Alliance and Chile Vision.*

In addition, the adoption of a new mandate on the portability of pension funds was welcomed by Chile. Chile and Peru signed agreements in this area, and the goal has been to extend these benefits to all workers in the Pacific Alliance. This promotes a freer circulation of people, while also insuring that all workers can count on retirement benefits, regardless of the time spent working in other countries of the Alliance. Further discussions are expected on topics such as the greater integration of the stock markets, pension savings, banking and the fixed income securities markets.[16]

In this area, as in many others, the active participation of the private sector is a key factor. As has been mentioned, the Business Council of the Pacific Alliance is a relevant actor, and its clear recommendations and input are taken into account in the work program of the four countries. At the Paracas Summit, the Presidents of the four countries, joined by IDB President, Luis Alberto Moreno, participated in the CEO Summit of the Pacific Alliance – Leadership Conference, where they had the opportunity to engage in lively dialogue with more than 500 Chilean, Colombian, Mexican and Peruvian businesspeople. The Conference provided an opportunity to review the progress and goals achieved by the Alliance since its creation in 2011, as well as to analyze the main topics that will foster growth during the next few years, including the private sector perspective on the future of the Pacific Alliance.

Finally, of special interest to Chile was the recognition by the other PA members that convergence that can be found with MERCOSUR on a basis of common interest areas upon which to build a closer relationship and exchange. All actions in these fields will serve to promote ever more dynamic trade and investment links among our countries. This will not only strengthen trade within the region, but also allow us to better face the Asia Pacific market.

Convergence in Diversity

Chile is both an active member of the Pacific Alliance and an associate member of MERCOSUR (the full members are Brazil, Argentina, Uruguay, Paraguay and Venezuela). As mentioned before, today's global economy is structured on the basis of highly integrated macro-regions: North America, Europe and Southeast Asia.

16. www.gruposura.com/en/news/press-releases/first-pacific-alliance-financial-integration-forum-held-in-chile.aspx

The political and economic strength of MERCOSUR countries is palpable; their presence in the regional GDP is close to 56%; and jointly, the Pacific Alliance and MERCOSUR represent 92% of the region's trade, 85% of the population and 91% of its GDP.[17] Beyond that, for Chile, México and Peru, MERCOSUR is the most important market in the region.

For Chile, strengthening the links between the Pacific and the Atlantic and moving towards a deeper integration are crucial elements for facing the current world economy. As stated before, the latest economic figures amply demonstrate that there is a need to reenergize growth through domestic and regional efforts; thus, integration can become a powerful incentive.

In this context, Chile seeks the convergence of the Pacific Alliance with other integration schemes in Latin America, such as MERCOSUR, thereby creating a bigger market and spanning the continent from the Pacific to the Atlantic. The reason for this is that Chile, as well as other members of the Pacific Alliance, needs to diversify its production and export matrixes, in order to diminish its dependence on the export of raw materials.

Chile is particularly interested in attracting investment in infrastructure, energy and production chains, as these are fundamental to link the economies in the region and promote more efficient trade flows to the rest of the world. In addition, there is a need to address and resolve institutional, financial, regulatory and operational roadblocks in order to achieve physical integration among countries in the region. One of Chile's goals is to become a bridge between the emerging markets of Asia Pacific and Latin American exports; much of this challenge hinges on improving infrastructure, be it physical, as in ports, roads, tunnels and bridges, or service network related, in the financial, transport, communications or logistics areas.

Without a doubt, the accomplishment of these tasks will move Latin America and the Caribbean toward a convergent integration, achieving better connectivity between the region and other regions in the world. But this will not be enough. The region must also move forward on other areas, such as energy integration, for example.

Latin America has vast energy resources, which are not equally distributed among countries. Despite the adoption of an ambitious energy agenda to address Chile's energy deficit, the country faces numerous short and medium term challenges for meeting its energy needs. Increased interconnectivity,

17. http://www.eltiempo.com/opinion/columnistas/alianza-del-pacifico-y-mercosur-heraldo-munoz-columnistas-el-tiempo/15404481

both domestic and regional, is an important objective. Thus, it is paramount that the Pacific Alliance move forward on energy integration and that it coordinates with other countries to make better use of the energy sources in the region, mainly through improved infrastructure. The region must also adopt innovative alternatives for exchanging energy for maximum benefits, while respecting domestic policies.

In the end, this is the basis for integration: the exchange of experiences and best practices, which will allow the region to advance as a group toward a greater good of our countries and citizens. Chile firmly believes that the Pacific Alliance can contribute to a greater regional integration, and that this can be done in convergence with other integration models in Latin America.

During 2014, two meetings were held between the MERCOSUR and Pacific Alliance countries. As a result of these meetings, there is today a general acceptance of the value of dialogue, and the possibility of further discussion on the matters of common interest has been reinforced, which will facilitate trade and investment within the region. This includes Trade Facilitation, electronic Sanitary and Phytosanitary Standards certifications and a greater participation in regional value chains. A convergence will strengthen the different models of integration in the region, while integrating Latin American countries into the globalized world, and linking regional initiatives on both sides of the Pacific.

Why Asia Pacific?

Today, Asia has a growing role in the global economy. In 2013, Asia Pacific represented 27% of global GDP, 35% of exports and 34% of imports. Total trade between Asia Pacific and the world amounted to US$ 1.266 billion, growing on average 13% annually in the last five years.[18] Considering these figures, these markets represent great opportunities for emerging markets exports, including those coming from the other side of the Pacific.

One of the reasons for the success for the swift and sustained growth of the Asia Pacific has been its rapid integration into global value chains and trade, particularly regarding exports to European and North American markets.

18. https://www.imf.org/external/pubs/ft/reo/2014/apd/eng/areo0414.pdf

Deep integration agreements, such as ASEAN, have impacted positively in trade and investment in the region. In fact, their GDP expanded at an annual rate of 5.4% in the period between 2004 and 2013, and remained steady at 5.5 percent during 2015.[19] In addition, most of the Asia Pacific countries are open economies and are important providers of capital goods, intermediate inputs and primary goods for China.

For the Pacific Alliance, a closer relation with ASEAN is an important objective, particularly as that regional bloc does not have close links with Latin America. The Pacific Alliance could become the leader in a process of interaction and strategic development as the natural ally of the ASEAN. There already is a growing interdependence between Latin America and Asia Pacific in energy and mineral trade,[20] which could be complemented by an active strategy by the Pacific Alliance to attract Asian investment in different economic sectors, thus diversifying the export baskets of both regions.

An interregional dialogue could maximize the probabilities of PA Members becoming an active business platform between Asia and Latin America, and thus increase the opportunities for trade and investment. Therefore, the task is to establish some mechanisms for joint work in those areas in which both blocs might be interested in establishing strategic alliances. Some conversations have already taken place and more are foreseen.

All Pacific Alliance countries have strong links with ASEAN, which will set the base for closer relations. Trade, as well as cooperation in terms of science, technology, green growth, education and innovation, are areas barely explored but with huge potential. At the same time, and given the challenges on the global stage, joint common positions can ensure that final commitments reflect regional demands and interests.

Chile is aware that nothing that happens in Asia Pacific can be disregarded: political processes, economic reforms, the fluctuating dynamism of the economies, the security of the transport pathways, in particular maritime ones, and the preferences of its investors. A clear demonstration of this has been in the recent market swings of the Chinese economy, which sent shock waves through global markets, including the regional ones.

For Chile, a closer relationship between the Pacific Alliance and Asia Pacific is a fundamental issue. Since the early nineties, Chile has looked

19. https://www.imf.org/external/pubs/ft/reo/2014/apd/eng/areo0414.pdf

20. The New Silk Road: Emerging Patterns in Asian and Latin American Trade for Energy and Minerals (June 2015), Ramón Espinasa, Estefania Marchan, Carlos Sucre (IDB Technical Note: 824).

westward and sought to establish a presence in the Asia Pacific countries. This is linked to Chile's policy of trade liberalization of goods, services and investment and diversification throughout the world as a means to grow and develop. Although our relations probably began when Japan and Chile established diplomatic relations in 1897, it's unquestionable that since the early nineties, we have made huge progress in linking the two sides of the Pacific. Our membership in APEC in 1994 signaled to the world our objectives, as have the coordination and collaboration that we carry out with our Asia Pacific partners in fora such as WTO and OECD.

In parallel to these multilateral actions and as trade with this region expanded, Chile began to negotiate bilateral free trade agreements with our partners: Korea (2004), China (2006), the P4 with New Zealand, Singapore and Brunei (2006), Japan (2007), India (2007), Australia (2009), Malaysia (2011), Vietnam (2014) and Hong Kong (2014). Chile's FTA with Thailand is under ratification, while we have started negotiations with Indonesia and Philippines is in the pipeline.

These FTAs have become essential tools for Chile's economic relations with Asia and the world. Out of Chile's vast network of agreements –24 with 62 countries–10 have been signed with the Asia Pacific region.

In trade terms, the region is Chile main destinations for its exports. During 2013, Asia received 48% of Chile's exports and was the origin of 31% of our imports.[21] Among the main markets are China, Japan, Korea, India and Taiwan on the export side, while China, Korea and Japan are the main source of imports. While most of Chile's exports to the Asia Pacific countries are primary products, such as copper, there has been an effort in the last decade to diversify exports. One area where this is evident has been the agroindustry, particularly wine.

With ASEAN, Chile has developed relations based on political, trade and cooperation links. On the trade arena, there are agreements with 5 ASEAN members (Singapore, Brunei, Malaysia, Vietnam and Thailand) and negotiations with Indonesia and talks with the Philippines.

Politically and diplomatically, Chile is also present, with Embassies in 10 Member States and with the Chilean Ambassador in Indonesia accredited as representative to ASEAN. South– South cooperation, through technical assistance and scholarships, has also been provided to 7 ASEAN countries

21. www.direcon.gob.cl

(Singapore, Thailand, Malaysia, Indonesia, Vietnam, Brunei and Laos). In addition, Chile participates in the Forum for East Asia and Latin America Cooperation (FEALAC), an inter-regional organization with 36 member countries from both East Asia and Latin America, which promotes cooperation in fields such as sustainable development, culture and investment.

Challenges

Nothing is perfect, and the Pacific Alliance also displays some apparent contradictions. Today, the four countries would like to continue diversifying exports, especially in value-added terms, as well as creating more opportunities for the service sectors. On the other hand, better use of the advantages of existing trade agreements must be made. This is especially true within the region.

As has been pointed out already, despite its members having signed the highest number of free trade agreements in the world, applying lower average Most Favored Nation (MFN) tariffs and having fewer non–tariff barriers than most Latin American countries, intra-regional trade among Member Countries represents just 4% of their total trade.[22] According to Herreros, this may be a consequence of the composition of their export baskets, which are quite similar, with raw materials such as copper, petroleum and coal playing a predominant role.

Nonetheless, a recent study by the BBVA[23] shows that there are some sectors with potential and that a better integration with global value chains could boost exports. Capital and intermediate goods in the fertilizer, paper and lumber products, and plastics, among others, have growth potential, as do cereals, electronic goods and plastics–specifically for Chile. Given this kind of information, it would appear that there is much room for growth. In parallel, the four members could also gain from joint work on market intelligence and on trade facilitation (cutting red tape, for example). Finally, a pooling of resources and know-how regarding export promotion, as is already happening, is a positive development.

One of the Alliance's greatest potentials may lie in attracting foreign investment, particularly from Asia, where all four countries have trade agreements.

22. *Ibid*., Herreros.
23. BBVA.

Officials from Japan, South Korea, New Zealand, the ASEAN countries and Australia have been especially enthusiastic about forging closer links–in some cases, seeing in the alliance a pathway to competing with China's growing influence in Latin America.[24] Thus, joint investment seminars might be positive, particularly for financing infrastructure projects, which could facilitate the transport of goods and the development of the service sectors.

The issue of membership [25] is another challenge. Would the Alliance benefit more by expanding its membership? Or should it consolidate its gains before expanding? And if it does choose the second option, will it lose dynamism and become less attractive to outsiders? There are no clear answers. Nonetheless, the four members are aware that they must address these issues, and proposals are being put forward, so as to avoid losing momentum, while giving feedback and guidance to the many interested parties.

24. http://www.economist.com/news/americas/21646273-pacific-alliance-great-brand-search-shared-product-how-deep-their-love

25. http://csis.org/publication/pacific-alliance-and-new-zealand

THE PACIFIC ALLIANCE: COLOMBIA'S VISION

Patti Londoño Jaramillo

The Pacific Alliance, whose members are Colombia, Chile, Mexico and Peru, is one of the most innovative and pragmatic integration mechanisms in Latin America. In a few years it has succeeded in strengthening trade and economic ties among the 4 countries, turning an area of over 200 million people into a zone of opportunity for entrepreneurs and investors of the member countries, as well as for other partners around the world.

During the 6th Meeting of the Latin American Pacific Arc Forum held in Cuzco, Peru, in October 2010, one of Colombia's main proposals was to accept integration at different speed among the members of this Forum, which, in addition to the four member countries of the Pacific Alliance, included the countries bordering the Pacific Ocean from Mexico to Chile, all through Central America.

This decision facilitated the initiative introduced in 2011 by Peruvian President Alan Garcia to create a trade group among Chile, Colombia, Mexico and Peru with the aim of deepening integration and market relations with other regions, particularly in Asia Pacific, based on the free trade agreements signed among the four countries.

This was the beginning of the Pacific Alliance, which was formalized on June 6, 2012 in Chile with the signing of the Framework Agreement. The aim is to build, jointly and by consensus, an area of deep integration to advance progressively towards the free movement of goods, services, capital and persons in order to promote economic growth, development and competitiveness of the member States, thus providing greater wellbeing for their nationals and furthering social inclusion.

This innovative mechanism for economic integration is based on a policy of open regionalism, making it an open and flexible process, with clear and pragmatic goals, that does not seek to counterbalance other regional initiatives

such as UNASUR, CAN, CELAC or MERCOSUR. The Pacific Alliance is focused on trade, investment and cooperation, making it a mechanism for the promotion of growth and development of the economies of its member countries. It is not a political coordination mechanism such as others; therefore, its economic and commercial nature does not duplicate any of the instances of Latin American political integration.

The Pacific Alliance has gained greater visibility due to the economic and commercial importance of its member countries. As a block, it constitutes the eighth largest economy in the world representing 35% of the GDP of Latin America and the eighth largest exporter, covering 47% of regional trade. In 2013, the Pacific Alliance economies had an average growth of 4.3% and an average inflation rate of 2.7%. In addition, they received 46% of total foreign direct investment in Latin America and the Caribbean.

The Alliance brings together 218 million people, of which 66% are working age population. The four countries receive 32 million tourists per year, with an average employment growth of 4.3% and an average unemployment rate of 7% for 2013. The average investment in education is 4.3% of GDP (2012).

Colombia considers that the Alliance may improve the indicators of each of its members, and recognizes that, for instance, some countries are more advanced in tourism or as regards integration with Asia Pacific. Hence the interest in joining forces and the efforts to achieve greater and better insertion into the flow of global trade and investment. These four countries are attractive to international partners and proof of that is the participation of 42 observer countries with whom the Pacific Alliance is developing agendas focused on strengthening key sectors, based on the four pillars of the Alliance. These observers consider the Alliance an opportunity for investment and associations with companies in the region, in order to reach the Latin American market, with over 600 million people, or markets like the US and Canada, which have standing free trade agreements with countries of the Alliance. It is worth mentioning that Sweden and Denmark were recently admitted as observers at the Summit held in Paracas, Peru, thus opening new partnerships and cooperation opportunities.

The Pacific Alliance is embedded in the center of Colombia's foreign policy, which seeks to consolidate the country's position and presence at global and regional levels. Therefore, implementing the Alliance projects has been a priority of President Juan Manuel Santos. The President of the Republic and the Ministers of Foreign Affairs and of Trade, Industry and Tourism have

focused, at the national level, on working with the different sectors to make the ambitious Alliance program viable and, at the regional level, on coordinating legislation and policies with the Pacific Alliance Member States.

Chile, Mexico and Peru are natural allies of Colombia. The four countries share fundamental values, which have allowed the creation of a common vision for laying the foundations of the Pacific Alliance. Prevailing in these countries are the rule of law, democracy, constitutional order and the separation of powers, as well as a fundamental respect for human rights. These are all prerequisites to gaining access into this mechanism. In addition, free trade and economic liberalization have become basic tools for growth, development and competitiveness of the economies of the four countries.

The Alliance is a flexible mechanism in its nature. This is reflected in its operation, which differs from the traditional model of regional integration in Latin America. The highest decision-making body is the Presidential Summit, which takes place once a year. Each member country is Pro - Tempore President on an annual basis. As part of the 10th Summit of the Alliance in July 2015, Peru assumed the Pro – Tempore Presidency, which had been held by Mexico the previous year. The Pro - Tempore President is in charge of following up on all issues and establishing the annual schedule of meetings.

The Council of Ministers is the body constituted by the Ministers of Foreign Affairs and the Ministers of Trade. It adopts decisions to implement the objectives and specific actions contained in the Framework Agreement and the Presidential Statements. The High Level Group formed by the Deputy Ministers of Foreign Affairs and of Trade monitors the work of the Technical Groups. The Technical Groups implement the mandates of the Presidential Statements.

The Pacific Alliance currently has 21 technical groups that develop actions in areas such as services and capitals, intellectual property, trade facilitation and customs cooperation, mining, consumer protection, innovation, education, external relations and migration facilitation, among others. As a result of the 10th Summit of the Alliance, held in Paracas, Peru, two new technical groups on culture and gender were created.

The commitment of the countries with the Alliance has been deep, both technically and politically. This is marked by its achievements since its creation and by the frequency and intensity of meetings between governments. By July of 2015, 10 presidential summits, 14 meetings of Ministers of Foreign Affairs and Trade Ministers (Council of Ministers), 25 meetings of deputy

ministers of foreign affairs and deputy ministers of trade (High Level Group) and 20 meetings of technical groups had been held.

One of the main achievements has been the signing of the Additional Protocol, in Cartagena, on February 10, 2014. It contains 19 chapters that expand the existing free trade agreements and modernize the existing bilateral agreements. Regarding market access, it provides relief for 92% of the tariffs immediately after its entry into force, while the remaining 8% will have periods of gradual reduction. The greatest achievement of this agreement is that it introduces a fundamental element to compete in a world of globalized production: the ability to accumulate origin of goods products among the four countries, allowing for a movement towards greater integration of production, as well as a greater involvement in regional and global value chains and increased levels of competitiveness.

As part of the 10th Summit in Paracas, Peru, on July 3, 2015, the trade ministers of the four countries signed the First Protocol Amending the Additional Protocol to the Framework Agreement, which includes a new chapter on regulatory reform, amendments and new provisions to chapters on electronic commerce and telecommunications, as well as a new annex to the Chapter on Technical Barriers to Trade in the field of cosmetics.

Other achievements can be noted in the promotion of exports, investment and tourism. Three macro business rounds and two macro tourism rounds have been held, which have allowed the potential of member countries' economies to stand out, and generating business and investment both within and outside of the Alliance.

As to the the free movement of capital, the Alliance continues to strengthen its integration through the stock exchanges in the Latin American Integrated Market (MILA), and will have to further deepen at other regulatory levels to achieve a greater harmonization of market integration.

The important role of the private sector in the Alliance, through the Pacific Alliance Business Council, is worth noting. Its recommendations have been very valuable to advance various projects developed within the working groups, for the free movement of goods, services, capital and other areas of cooperation.

Another important development for the Alliance has been the facilitation of movement of persons. Initially, the four countries abolished visas for tourism and business for up to six months starting on 2012. This decision had immediate and positive effects in terms of tourism. In 2014, Colombia received approximately 335 tourists from Chile, Mexico and Peru, 41% more

than in 2012, exceeding the average growth of tourism in the same period in the country, which was 24%.

The Pacific Alliance also boasts a Student Mobility Platform that promotes the exchange of undergraduate and graduate students, teachers and researchers among the four member countries. Each country grants 100 scholarships annually: 75 for undergraduate and 25 for doctoral studies, research and faculty mobility. So far, 855 scholarships have been awarded.

In June 2014, the Ministers of Foreign Affairs of the Pacific Alliance signed the "Agreement for a Working Holiday Program," which allows Member States' young people–between the ages of 18 and 30–to temporarily enter the territory of any of the other countries for holidays and engage in a temporary activity in order to cover the costs of their stay while in the host State.

The Platform for Immediate Information Exchange for Immigration Security of the countries of the Alliance has recently been implemented; this seeks to provide security and traffic safety for travellers. This platform will serve to consolidate future projects, such as a Pacific Alliance visa.

Another great achievement has been the opening of shared Embassies in Ghana, Morocco, Algeria, Azerbaijan, Vietnam and Singapore, as well as the Permanent Mission to the OECD in Paris. With this, international presence is increased and costs are being saved. The Consular Assistance Agreement strengthens the assistance that can be provided to the nationals of the four countries in places where they do not have consulates from their countries of origin. Additionally, two joint trade promotion offices have been established in Istanbul and Casablanca, which we hope will bring us closer to these regions.

In May 2013, the Alliance established the Cooperation Fund, with annual contributions of 250,000 USD by member States, and possible contributions from third parties to finance common projects.

In this way, the Pacific Alliance becomes the first Latin American regional integration initiative that is seeking projection to Asia Pacific. The interest in approaching Asia reflects one of the fundamental objectives of the Alliance: to become a platform for economic and trade integration and projection to the world, with a special emphasis on Asia Pacific. This priority has strengthened, especially for Colombia; relations with countries like Australia and New Zealand and it has also allowed many Asian countries that have closer ties to Chile or Mexico to turn their eyes to Colombia for their investments and to increase their overall presence in Latin America.

The Alliance has succeeded in approaching the Association of Southeast Asian Nations (ASEAN), an example of open regionalism, committed to

advancing diversity, bearing in mind a common goal: to create a stable, prosperous and highly competitive region, which are objectives also shared by the Pacific Alliance. Three meetings have been held at the level of ministers and of delegates. There is also a joint Pacific Alliance- ASEAN statement agreeing to promote economic cooperation in facilitating trade and investment flows.

Colombia, in its efforts to strengthen its presence and participation at the regional and global levels, has obtained significant benefits from the Alliance, through cooperation programs, educational and cultural exchanges, mobility of people, shared missions and relationships with other countries, especially in Asia Pacific. It is also occurring at the level of strengthening intraregional trade and the generation of added value chains, making it some of the most significant achievements of the Alliance in commercial terms.

The Alliance must continue developing the agreement, but also start working on new initiatives to identify and strengthen other areas of common interest such as small and medium scale enterprises, innovation, entrepreneurship, education, International Single Windows for Foreign Trade and drive forward the agenda on financial matters.

The Alliance faces major challenges, and one of them is to maintain the vitality and the tangible results that have been obtained so far.

Colombia, in recent years, has developed a pragmatic and results-focused foreign policy. It has concentrated on strengthening its relations with Latin America and the Caribbean, and in this context, the Pacific Alliance is undoubtedly the most important community project. It has also focused on diversifying its relations with countries in Asia Pacific and Central Asia to expand opportunities for students, academics and entrepreneurs. Significant progress has also been made with Africa in providing cooperation on sectors such as food security and the fight against the global drug problem.

Colombia believes in regional integration and respect for political and ideological differences to advance projects that unite countries and bring benefits for all. This foundation has allowed us to maintain dynamic relations with all countries and deepen strategies for regional and international insertion.

It is in this context that the Pacific Alliance is a significant factor in Colombia's foreign policy. It is a reflection of the economic and commercial opening of the country, its regional vocation and long-term vision, while understanding that the international system is aimed towards regionalization to potentiate the competitiveness of economies and markets in a global system.

We understand that it is necessary to work together with like-minded countries to compete in an increasingly globalized world, with rules applicable

to all and opportunities in any country or region in the world. The frontiers of knowledge, technology or mobility of skilled people fade more and more, and the benefits of this international convergence for our citizens depend on the decisions we make now.

The Pacific Alliance is one of our most successful expressions of foreign policy in understanding the development and future of the international system. We will continue assuming the challenges of strengthening a mechanism of this nature for the compensation we seek in terms of economic and social development, with the ultimate goal of achieving prosperity and equality for all Colombians.

PERU AND THE EVOLUTION OF THE PACIFIC ALLIANCE AS A REGIONAL ECONOMIC INTEGRATION PROCESS

Ambassador Eduardo Martinetti Macedo

I. Introduction

The Pacific Alliance is a dynamic and innovative integration process, with an economic-commercial profile which seeks to create an area of deep integration to unleash the growth and competitiveness of the economies of its member countries in order to achieve greater welfare for its people, overcome inequalities and promote social inclusion of its citizens. Similarly, the Pacific Alliance aims to become a platform for economic and trade integration in the world, particularly in the Asia-Pacific region.

Its creation is the product of careful reflection on the limitations of regional institutions to work out the desire for a real and effective integration, often tinged with political, ideological variables, differences of views and different levels of development and economic models among its members. This process of deep integration has been assumed by Peru as a State policy, and the Peruvian government is firmly committed to its objectives and its development.

The initiative was launched in late 2010, when Peru summoned several countries in the region with the proposal to form an Area of Deep Integration to advance in the liberalization of trade in goods, while ensuring the free circulation of services, capital and people, as a strategy to consolidate a common economic platform to project to the Asia-Pacific and to the world, in a context where negotiations within the proposed "Latin American Pacific Rim" were stagnant.[1]

1. See Briceño Ruiz, Jose. "The Initiative of the Latin American Pacific Rim. A New Actor on the Stage of Regional Integration" in: New Society 228, July-August 2010.

The Pacific Alliance does not intend to compete with other organizations and regional mechanisms, but is rather an integration mechanism open to those countries which adhere to its principles and objectives, as well as to the values that inspired it and the standards and requirements which have been raised by the founders, having a shared vision that allows to set its own identity as its central core.

In that sense, this article will develop the formation process of the Pacific Alliance and the decision of Peru to promote its inception, detailing the steps of said integration scheme and the logic with which each one was implemented in order to achieve the objectives set by member countries since the signing of the Lima Declaration on April 28, 2011.

II. Peru's bet for Integration

According to the findings by various authors, after World War II, there were two waves of regionalism in Latin America, called the old and the new regionalism, referring to the old one as the process by which it was sought to promote the gradual integration to overcome limitations of scale that the Industrialization Model by Import Substitution showed at national level in the region, and the second one as the process of trade liberalization to achieve complementarity with the multilateral trading system, through the depoliticization of the integration process.[2]

Currently, Latin America is going through a new stage of regionalism, derived from the conceptual turmoil and great changes in the international context, as a result of the political, economic and social crisis of the late twentieth century and the subsequent great economic crisis of 2009 which brought the end to the neoliberal stage in the region and from which a period of rebuilding of the State's role and search for a model of development with social inclusion began.[3]

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2. See Bhagwati, Jagdish. "Regionalism and Multilateralism: An Overview." In: New Dimensions in Regional Integration, edited by Jaime de Melo and Arvind Panagariya, 22-51, 1993, New York: Cambridge University Press. De Lombarde, Philippe, Koichi, Shigeru and Briceño Ruiz, Jose. "Latin American Regionalism to the Interregional Integration" 2008, Spain: Siglo XXI.

3. See Perrotta, Daniela. "Regional integration as an object of study. From Traditional Theories to Current Aapproaches" in Llenderrozas, E. (ed.) International Relations: Theories and Debates, Buenos Aires: EUDEBA, 2013, p. 244. Sanahuja, Jose Antonio, "From the Open Regionalism to the Post Liberal Regionalism. Crisis and Change in Integration in Latin America and the Caribbean. In L Martínez, L Pena and Mariana Vasquez (eds.), Yearbook of the regional integration of Latin America and the Grand Caribbean 2008-2009, Buenos Aires: Regional Coordinator of Economic and Social Research-CRIES, 2008, pp 30-33.

In that context, Peru, which traditionally has had a foreign policy with a sense of solidarity and involvement with the South American States (Bruce St John, 1999, p. 10), reflected on the limitations of the regional institutionality to materialize the aspiration for a real integration to allow for a general welfare of the population with social inclusion, and decided to promote the creation of a space to consider the Pacific as the linchpin of its international insertion in a scenario where Venezuela had decided to abandon the Andean Community in April 2006.

In this regard, the statements of former Minister of Foreign Affairs Jose Antonio Garcia Belaunde are important. He noted in July 2006 that the main scope of the Peruvian diplomacy remained in South America and the Andean Community, but also proposed a major project, the Latin American Pacific Association, whose role would be to promote a set of trade, cooperation and political ties along the entire Pacific coast of Latin America (Garcia Belaunde, 2006), reflecting the early importance that the Peruvian foreign policy gave to integration in that region.

Therefore, after several meetings promoted by Peru with senior officials of the Latin American Pacific States and the positive reception that the proposal found in most countries, it was decided to convene a meeting in Cali to formalize the creation of the Forum on the Initiative of the Latin American Pacific Rim with the Declaration of Santiago de Cali, noting the commitment to promote joint actions to allow a more dynamic cooperation within the Latin American Pacific Rim countries, towards a major rapprochement with the Asia-Pacific, and in order to facilitate and promote trade and investment, benefiting from the insertion into international markets, and improving competitiveness in order to improve the quality of life of their populations.

The Forum continued to meet for annual ministerial meetings, which were held in August 2007 in Lima, in April 2008 in Cancun, in October 2008 in Santiago de Chile, in October 2009 in Puerto Vallarta and in October 2010 in Urubamba. At every meeting, the objectives mentioned above were repeated, emphasizing its commercial aspect.

Since the third Declaration of Cancun, the Forum, also known as the Forum of the Latin American Pacific Rim, was integrated by Colombia, Costa Rica, Chile, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Peru. However, it was losing strength, as the differences among member countries did not allow for an advance on the agreed agenda. There were also two withdrawals, those of Ecuador and Nicaragua, which disrupted the territorial continuity of the initiative. (Kahat, 2011)

Facing this reality, the Peruvian government proposed to a number of governments, in October 2010, the creation of an Area of Deep Integration to advance an agenda that would allow for the free movement of production factors. Following that proposal, the Presidents of Peru, Mexico, Colombia and Chile met in Mar del Plata on December 4th, 2010, during the XX Ibero-American Summit.

Subsequently, with the process further defined by preparatory meetings at the technical level, the Presidents of Peru, Colombia, Chile and Mexico met in Lima on 28th April 2011 and signed the Presidential Declaration on the Pacific Alliance, which launched this initiative. In this Declaration, the Ministers of Foreign Affairs and Foreign Trade were entrusted to develop the Framework Agreement of the Pacific Alliance, signed in June 2012, which established the structure, principles and goals, as well as the cornerstones of this integration mechanism.

It is worth mentioning that with the founding of the Pacific Alliance, the four basic principles of integration in the Americas, issued from the second wave of regionalization and gathered by Amado Luiz Cervo, were broken and complemented, namely: 1) that integration essentially depends on the interest of the economic actors, to which the political will of governments is added, 2) that integration must necessarily start from existing trade flows, 3) integration must be accompanied by trade liberalization to create a production area and 4) continental integration is created from a sub-regional scale (Cervo, 2001, p. 11).

The Pacific Alliance, created from a homogeneous view of the international context and the same convictions about development - a reflection of the common identities among its Member States - breaks the pre-set integration schemes in the region and sets to understand international politics as a situation that is generated from facts, identities and interests, which are formulated and supported by inter-subjective practices, emphasizing the identity element, since it is understood that the interests are socially constructed according to the identities of the actors.

In that sense, and despite of the fact that intra-regional trade among its members was meager, the political will of the governments of the Member States was crucial in the conception and creation of this integration mechanism. Also, while it is true that the Pacific Alliance has an important trade component, it is seen as a tool to achieve greater social inclusion and higher welfare for their populations, these objectives being complemented with major cooperation projects that have been established and executed since its inception. Finally, it should be emphasized that the Alliance was created in spite

of it not having a territorial continuity and among States located in different sub-regions.

Similarly, the conviction of the Member States in achieving greater integration into the international economy, and especially to promote and develop regional value chains must be stressed. This led the member countries of the Pacific Alliance to join efforts in order to establish closer links to the most dynamic trade and investment flows in the world.

Public policy actions taken by the countries of the Pacific Alliance have certainly succeeded, as they are among the top five in the region in terms of economic freedom, according to the Index of Economic Freedom 2014. They are the four most competitive economies of Latin America according to the World Economic Forum (WEF) and the four countries with the best business climate in the region, according to Doing Business 2015. In addition, it is estimated that their economies will also be the most dynamic in the next 10 years, and that they will grow by an average rate of 4.5% annually (Bertelsmann Foundation, 2015).

In addition, the Alliance countries have been taking actions to join various cooperation mechanisms. All four countries are members of the Pacific Economic Cooperation Council (PECC), the Pacific Basin Economic Council (PBEC) and the Forum of East Asia-Latin America Cooperation (FEALAC). Similarly, Chile, Peru and Mexico are members of the Asia-Pacific Economic Cooperation Forum (APEC).

In the case of Peru, for more than 20 years important steps have been taken to achieve greater integration into the international economy through the adoption of various policies in favor of free trade and the free movement of goods, people, capital and services. Through such policies, a greater welfare for the population, and its social inclusion, can be achieved.

In this context, the strengthening of closer external links with Asia, and the Asia Pacific in particular - considering that the region accounts for nearly half the world's population and that its participation in global economic growth is substantial (International Monetary Fund , 2014) - has been at the center of the priorities of Peruvian foreign policy. Moreover, the 21 APEC economies represent today almost half of world trade, and the Asia Pacific countries are among Peru's most important trading partners (PROMPERU, 2015).

This process was complemented by the signing of multiple Free Trade Agreements with important trading partners in the region such as China, Korea, Japan, Singapore and Thailand, as well as agreements to promote and protect investment and to avoid double taxation.

III. Phases of the Pacific Alliance

3.1. *Phase of constitution and definition of principles*

The Pacific Alliance has as its foundational milestone the Lima Declaration, signed on April 28th, 2011, in which the Presidents pledged to advance "*progressively towards the goal of achieving free movement of goods, services, capital and persons.*"

Its foundation took place in a post-crisis international scenario, where the structures of international society were reconfigured due to the 2008-2009 crisis, which made clear the inadequacy of global institutions to face the new challenges of this century. The replacement of the G7 with the new G20 was a clear expression of this rearrangement in the global economy.

In this context, competition policies in national economies and in international trade took on greater importance. In addition, global and regional value chains tended to be redefined in terms of the recovery capacity of the various economies in the face of the crisis, access to scarce raw materials and the appreciation of geographic and logistical advantages (Rosales, 2010, p. 26).

Considering this scenario, the member countries of the Pacific Alliance found mixed opportunities and risks for their various sectors, which they decided to confront through a process of integration with countries with the same convictions, in order to improve the competitiveness of their economies, considering the magnitude of the challenges and levels of quality, scale and productivity required in the global economy.

In the aforementioned Lima Declaration, the Heads of State instructed their Ministers to draft a Framework Agreement and created the High Level Group (HLG) of Vice-ministers of Foreign Affairs and Foreign Trade, in charge of overseeing the work of the Alliance and its first four technical groups.[4]

These four technical groups, whose number was increased gradually, began their work focusing their efforts in the next phase, the creation of a free trade area, an area of free movement of persons and the first initiatives of

4. In the Lima Declaration the following technical groups were created:
a) Movement of Business Persons and Migratory Transit Facilitation.
b) Trade and Integration (trade facilitation and customs cooperation).
c) Services and Capital (integration of the stock exchanges).
d) Cooperation.

cooperation. It thus reflects the commercial focus of the mechanism, but also its interest in serving as a tool to boost social inclusion and the well-being of their peoples; some evidence of this are the cooperation programs that were executed from the beginning, and which will be described later in the text.

The Third Summit was held in virtual mode on March 5th, 2012, an occasion in which the Presidents approved the text of the Framework Agreement of the Pacific Alliance, signed at the Fourth Summit in Antofagasta, on 6th June 2012. The vision of the Pacific Alliance, which could be condensed in a combination of democracy as a fundamental principle of government with free trade as an essential tool for development, is reflected in Articles 2 and 3 of the aforesaid Agreement.

In summary, the Pacific Alliance was founded on a solid core of perceptions and ideas about how the world works and the validity of certain values and principles, which have been gradually strengthened by the creation of a certain institutionality. The belief of member countries is that shared values evolve and feed off each other, through the effectiveness of policies that are developed, as we can see in the next stages of the integration mechanism.

3.2. *Phase of creation of a free trade zone*

The creation of a free trade zone followed the path set by the Lima Declaration and the Declaration of Merida, in which it was decided to negotiate parallel agreements on trade that deepen and broaden the benefits and preferences that the four countries mutually granted under the bilateral FTAs, after the signing of the Framework Agreement the approach of the integration mechanism focused on creating a free trade zone.

To that end, the Declaration of Paranal, which was signed at the Fourth Summit, defined mandates and instructions to advance in the negotiation of a trade agreement and reach new and ambitious understandings in the reduction of technical barriers to trade, customs cooperation, good regulatory practices, sanitary and phytosanitary measures to facilitate trade, government procurement, investment and deepening of integration in services and capital, and especially in the customs duties treatment regarding the universe of goods and on accumulation of origin.

The Additional Protocol was finally signed at the Eighth Summit of Cartagena de Indias, on February 10th 2014, and is currently in the process of internal ratification in the four countries.

Significantly, the decision to create a free trade zone took place even though trade flows between member countries of the Pacific Alliance were moderate. Latin America has poor trade integration in general, between 15% and 20% of its total foreign trade, a distant percentage compared to the 50% percentage that exists in Asia, or the 70% in Europe (Blanco, 2015, p. 5).

The four countries of the PA traded together a volume close to $ 21,000 million in 2013, with Mexico as the country that exported more to the rest of the Pacific Alliance ($ 8,590 million), followed by Chile ($ 4,153 million), Colombia ($ 3,709 million) and Peru ($ 3,022 million). On the other hand, if we look at imports, the country that purchases a higher volume of goods from the Pacific Alliance is Colombia ($ 7,270 million), followed by Chile ($ 6,022 million), Peru ($ 4,614 million) and Mexico ($ 2,935 million) in last place. The main trade partners of the Pacific Alliance countries are the United States, China and the European Union, which together account for Mexico 85% of exports and 75% of imports, for Colombia 54% of exports and 57% of imports, for Chile 50% of exports and 54% of imports, and for Peru 50% of exports and 50% of imports. On the contrary, the Pacific Alliance represents an average of 5.3% of the total exports of the countries of the Pacific Alliance itself and 7.8% of imports (Blanco, 2015, p. 6).

In that sense, the decision of its creation is based on the common beliefs of the four member countries and the boost of their business communities, which later formed the Pacific Alliance Business Council (CEAP, by its acronym in Spanish) in Mexico City, on 29th August 2012, and has served as a valuable interlocutor between the Pacific Alliance and the business sector. As part of the Alliance, an expert committee was set up to constantly assess the proposals of CEAP, this being a first tangible result of feedback of the shared values with which the integration mechanism was created.

3.3. *Phase of creation of a zone of free movement of persons*

From the beginning and in parallel to the negotiations of its institutional and commercial components, the Pacific Alliance was reaching important agreements on free movement of persons; this is a dimension of the highest importance, based on the understanding that the rules are also an instrument governing the conduct of the State and which cooperate with the redefinition of national interests and the development of collective identities of its members.

The Lima Declaration of April 28th, 2011, established the Technical Group on Mobility of Businesspeople and Immigration Transit Facilitation (hereinafter known as the People Mobility Group), which would prioritize "the movement of businesspeople and facilitation of transit immigration, including the immigration and consular police cooperation." The Framework Agreement highlights as one of its objectives "to promote cooperation between immigration and consular authorities and facilitate the movement of people and immigration transit through the territory of the Parties," as a tool to achieve the goals of deep integration, growth and competitiveness of the mechanism.

Based on these precepts fostered in several Summit Declarations, the following actions were taken:

1. On November 2012, Mexico announced the elimination of visas for nationals of Colombia and Peru, as nationals of Chile were already exempted from visa requirements to enter Mexico. The visa exemption granted by Mexico included any unpaid activity.
2. In May 2013, Peru announced the elimination of visas for businesspeople from Chile, Colombia and Mexico for up to 183 days as long as they carry out only unpaid activities in the country.

Through these unilateral decisions, the member countries of the Pacific Alliance consolidated a space for mobility of people entering their territories for up to six months for unpaid activities, such as tourist, transit or business trips.

With this first finished dimension, the Alliance began to work, based on the mandates of the Summit of Merida, on the facilitation of measures for immigration transit, youth mobility agreements to travel and work, and consular cooperation mechanisms, in which significant progress has been made.

3.4. *Cooperation within the framework of the Pacific Alliance*

Although, as already stated, the profile of the Pacific Alliance is predominantly economic and commercial, early member countries assigned a high importance to cooperation as an instrument to develop and strengthen their capabilities. Through cooperation, the Pacific Alliance defines itself as an integration mechanism that contributes to economic growth with social inclusion.

On December 4th 2011, the Ministers of Foreign Affairs signed a Memorandum of Understanding on the "Pacific Cooperation Platform," in order to promote the collaboration of the four countries on priority issues of common

interest, such as environment and climate change; innovation, science and technology; micro, small and medium enterprises; and social development. The Technical Cooperation Group was also created.

During 2012, three cooperation projects of the Pacific Alliance were approved and launched: 1. The Platform of Student and Academic Mobility of the Pacific Alliance, 2. The Scientific Research Network on Climate Change, and 3. "Improving competitiveness of micro, small and medium enterprises." Also, the "Agreement on Tourism Cooperation," under the Memorandum of Understanding on the Pacific Platform for Cooperation, was signed in 2012.

In November 2012, within the framework of the V Summit of Cadiz, the Presidents instructed to move forward with negotiations to form the Joint Cooperation Fund of the Pacific Alliance, in order to provide "stability and predictability to the funding of cooperation programs in the short and medium term." In May 2013, the Ministers of Foreign Affairs signed the Agreement for the establishment of the Fund at the Seventh Summit of Cali, as a "facilitating mechanism, revitalizing and allowing the financing of cooperation within the framework of the PA." This Agreement is in the final stage of internal ratification in member countries and it is expected that the Find will begin its activities in 2016.[5]

3.5. *Phase of consolidation and implementation of mandates*

With progress in the steps described above, the Pacific Alliance focused on strengthening the mechanism. The Declarations of Punta Mita of June 20th, 2014, and of Paracas of July 3rd, 2015, adopted actions aimed at fulfilling pending mandates and new instructions that would allow the consolidation of the progress made to date. Among the most important actions are the following initiatives:

- Developing and implementing, within the framework of trade facilitation, the interoperability platform of the Single Windows for Foreign

5. Up until June 2015, cooperation records the following seven (7) projects (the first five running, the sixth in formulation and the last completed): Platform of Student and Academic Mobility of the Pacific Alliance; the "Regional Integration for the Promotion of Sustainable Production and Consumption (PyCS) of the Pacific Alliance Project"; Sports Diplomacy; Scientific Research Network on Climate Change (RICCC); Youth Volunteer Program of the Pacific Alliance; Great Cultural Exhibition of the Pacific Alliance; exchange of experiences for strengthening the promotion and enhancement of competitiveness and innovation of MSMEs (micro, small and medium enterprises).

Trade (VUCEs, by its acronym in Spanish) with the phytosanitary certificate with a view to commencing interoperability in the first half of 2016 and promote the implementation and strengthening of the Authorized Economic Operator programs.

- Approving the "Protocol of Immigration Information Exchange" and the List of Crimes, necessary tools for the full implementation of the Platform for Immediate Information Exchange for Immigration Security.
- Developing standards and criteria for the provision of professional services to facilitate the movement of professional services providers in the region.
- Starting the construction of a Common Digital Agenda, aware that our integration into the digital world will have a decisive impact on our economic and social future.
- Permanently institutionalizing the Platform for Academic and Student Mobility as a program that has contributed to the training of high-level human capital and the internationalization of higher education in the region.
- Establishing a public-private agenda for the development and promotion of innovation in the fields of business, education, government and investment.
- Progressing in the design of the following projects commissioned to member countries for implementation: Incubation and Acceleration Programs, led by Colombia; the Innovation Award of the Pacific Alliance, led by Chile; the Technology Transfer Forum, led by Mexico; and the Joint Innovation Office, led by Peru.
- Promoting the structuring of the first regional investment vehicle of Entrepreneur Capital Fund in order to start operations in 2017.
- Continuing to promote the work of relationships with Observer States and third parties in order to identify cooperation projects that contribute to the objectives of the Pacific Alliance.

In that sense, as seen along the development of the integration process, the initiatives presented in the mechanism have a continuous progress that feeds from the positive results that have been obtained.

3.6. *New generation matters in the Pacific Alliance.*

The Paracas Declaration of July 2015 includes new generation areas[6], which will be driven by the Finance Ministers of the Pacific Alliance in an articulated manner with the Council of Ministers of the Pacific Alliance.

During 2015, the Finance Ministers of the Pacific Alliance, aware of the need to deepen economic and financial integration, met twice in Washington D.C. on April 18th and in Mexico on June 26th-27th, 2015. These meetings allowed the identification of areas that have been incorporated into the work of the Alliance, around four core ideas: financial integration, infrastructure investment, management of catastrophic risk and management and fiscal transparency.

With regard to financial integration, initiatives have been identified to consolidate the capital market of the Alliance through the strengthening of the Latin American Integrated Market (MILA, by its acronym in Spanish)[7], including broadening the range of financial instruments and tax equivalence[8] that avoids the double taxation of income earned in the capital markets. In this direction, the regulatory frameworks of the countries are being harmonized; at the same time, it is sought to provide greater flexibility for investments of private pension funds, so that investors can invest in any country of the Alliance as being its own country, thus seeking future recognition and mobility of pensioners' savings. Similarly, the MILA is working towards the common recognition of IPOs.

Concerning infrastructure investment, and given its close relationship with the issue of competitiveness, it is sought to strengthen the dialogue on investment and infrastructure development; primarily in the communications, transportation, water resources, environmental conservation, tourism, power generation, renewable energy and public services sectors. To this end, one of

6. Annex 2 of the Declaration of Paracas.

7. MILA is integrated by the stock exchanges of Colombia, Chile, Peru and Mexico, with more than 950 listed companies with a total value of approximately US $1.1 trillion. MILA arises from an agreement to establish a regional market for buying and selling shares, thereby constituting an initiative of transnational securities or corporate merger integration without integrating globally. A deepening of MILA involves the development of an institutional framework for integration and regulatory harmonization of stock exchanges, expanding the range of financial instruments offered, tax and stock exchange harmonization, as well as harmonization and the interconnection of payment systems. All of these to be accompanied by the definition and implementation of an integrated supervision model with international standards.

8. It should be noted that Peru recently passed Law 30341, which promotes liquidity and market integration and specifies exemptions from income tax (IR) to capital gains from the sale of shares on the Lima Stock Exchange. This action is consistent with the pursuit of greater tax uniformity with the other countries of the Alliance, as stated by the Minister of Economy of Peru.

the first actions being carried out is the preparation of a study to standardize frameworks promoting investment in infrastructure. Later, the Alliance plans to analyze and develop proposals for boosting investment in the areas described, thus enhancing participation of institutional investors.

In the field of management of catastrophe risk, we are seeking to develop innovative strategies for integrated risk management of disasters (such as earthquakes or El Niño), including measures for financial protection and assurance based on a policy of risk transfer to capital markets; and study the feasibility of the parties to make joint risk transfer through financial vehicles such as bonds or reinsurance in international markets.

Finally, in management and fiscal transparency, it was agreed to strengthen dialogue in the implementation of best practices; make diagnostics of fiscal management and transparency standards to determine joint areas of opportunity; as well as to continue the works in order to meet the highest standards for automatic exchange of information.

3.7. *External Relations of the Pacific Alliance.*

External relations are fundamental to the international projection of the Pacific Alliance and the achievement of its objectives. The Framework Agreement of the Pacific Alliance establishes in its preamble the promotion of regionalism as a way to insert Member States in the globalized world and establish links with other regional initiatives.

In that sense, the Pacific Alliance shows three dimensions in its external relations. On the one hand, it embraces open regionalism, making partnerships with other groups of regional integration, a dimension that explains the major approaches to the Association of Southeast Asian Nations (ASEAN), in order to advance the goal of linking with the Asia Pacific.[9] Similarly, a dialogue with MERCOSUR has begun, through meetings between the two integration schemes.[10]

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9. To date, two meetings with ASEAN have been completed: I Pacific Alliance-ASEAN Ministerial Meeting in New York in September 2014, and the seminar of mutual understanding AP-ASEAN held in Jakarta on May 25th, 2015. In September 2015 the Second AP-ASEAN Ministerial Meeting, in compliance with the above took place, to agree on an agenda of shared work.

10. To date, there has been a Meeting of Ministers of the Pacific Alliance and Mercosur, held on the 1st of November 2014 in Cartagena de Indias, as well as the seminar "Dialogue on Regional Integration: Pacific Alliance-Mercosur" held on November 24th, 2014, in Santiago de Chile.

On the other hand, the external relations take place through the relationship with the Observer States, a dimension that is regulated in Article 10 of the Framework Agreement. The acceptance of Observer States corresponds to the Council of Ministers, a body responsible for defining the participation conditions of those States. The External Relations Group (GRE) has been commissioned to design a linking strategy with Observer States and third parties and generate a continuous and fruitful exchange with them, allowing for the promotion of the Pacific Alliance objectives.

So far, the Pacific Alliance has 42 observers from five continents. In the X Summit of the Pacific Alliance, held in Paracas in July 2015, 10 new Observer States were accepted. It should be noted that from that number, two States, Costa Rica and Panama, have the status of Observer-Candidates; it is expected that in the future, the Pacific Alliance shall have five or six full members. Other countries such as Honduras and Guatemala have also expressed their desire to join the Alliance as full members.[11]

Finally, the third external relations dimension is with international organizations seeking to strengthen linkage mechanisms that should serve the objectives of the Pacific Alliance, and certainly to its four pillars. In this regard, since its inception, the Pacific Alliance has been supported by the Inter-American Development Bank (IDB), and later, the Development Bank of Latin America (CAF, by its acronym in Spanish). It should be noted that both organizations were represented at the highest level in the Summit of Paracas. Also, the Pacific Alliance has ties with the Organization for Economic Cooperation and Development (OECD) and the European Union (EU), both also present at the Summit of Paracas, the latter having been invited to the next meeting of the GRE, an occasion in which a common agenda is expected to be defined.

Through these three dimensions the Pacific Alliance, seeks to consolidate its identity and network with other international actors who share its vision and principles in order to carry out projects allowing for the achievement of its objectives.

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11. Given the importance that for the Pacific Alliance represents the work with Observer States and the establishment of modalities and areas of cooperation of mutual interest, they were invited to the last two summits, in Punta Mita, on April 2014, and in Paracas, on July 2015. Also, the Group of External Relations (GRE), in order to develop a linking strategy with Observer States, has, to date, held three meetings with groups of Observer States, which clearly expressed their interest in carrying out specific projects with the Pacific Alliance. A fourth meeting of the Group of External Relations with Observer States, on the occasion of the XXII Round of Technical Groups prior to the XXXII Meeting of the High Level Group, to be held in the city of Punta Arenas, in Chile, is being held on October 20th, 2015.

V. Conclusions

After having analyzed the genesis and development of the Pacific Alliance, one can conclude that this integration mechanism forms a part of the third wave of regionalization, called post-liberal, because despite having a commercial economic profile, it also understands the process as a tool to achieve greater social inclusion and overcome existing inequalities in its Member States.

An important factor in its design and creation was the similarity of views and beliefs on the development model and its relationship with the international context, which led to its creation, despite of the fact that it was not based on the four basic principles of integration in the Americas emanating from the second wave of regionalization. Since then it has been set up as the first regional integration mechanism that has made substantial progress based on common convictions of its members.

During the process of design and creation, it is worth mentioning the role played by the Peruvian diplomacy, which recognizing the similarities of the challenges of the Latin American Pacific Rim countries, promoted the creation of the Pacific Alliance based on their countries' shared principles.

In short, the Pacific Alliance emerges as a bet for regional integration based on the necessity to address common challenges, such as the reduction of poverty and socio-economic inequalities in the domestic sphere of each member country and those in the international context, which require the consolidation of stable and attractive regional areas for investment, as well as for international trade, that promote the innovation and competitiveness of their economies.

In that sense, the process of creation the Pacific Alliance was established, at first, as a roadmap that sought to amalgamate the identities in the Latin American Pacific Rim, which led to identify a group of countries with the same identities and beliefs. In a second stage, from the consolidation of the group of countries with a common vision, consensus was generated through the signing of the Declaration of Lima that created the Pacific Alliance based on the formalization of common principles and convictions regarding the importance of integration as an effective tool for improving economic and social development of our peoples. Finally, there is an institutionalization and consolidation, through the subscription of its Framework Agreement, which sets its internal organization and objectives, and the Additional Protocol to the Framework Agreement, which seeks to create more opportunities for economic operators,

creating a free trade zone in the region, so that participation in an expanded market is facilitated, as well as the promotion of regional value chains with a view to projection into Asia Pacific.

The entry into force of the Framework Agreement of the Pacific Alliance represents an important milestone in the progress of the integration process, given that this agreement will enable the Alliance to acquire international legal obligations as a bloc. To this fact, we must add the next entry into force of the Additional Protocol to the Framework Agreement, which will substantially increase intra-regional trade and accumulation of origin aimed to export to third markets and of the Cooperation Fund, which will provide the Alliance with resources to finance its cooperation projects. In this regard, the full implementation of these three treaties provides the Alliance with a road map to follow and a promising future, characterized by the stability and strength of the States that take part in it.

Peru, as the promoter of the creation of the Pacific Alliance and currently holder of its Pro Tempore Presidency, is fully committed to the progress of this integration scheme and deploys every possible effort, together with its partners Chile, Colombia and Mexico, to achieve its objectives.

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LATIN AMERICA'S DECADE OF GROWTH: PROGRESS AND CHALLENGES FOR A SUSTAINABLE DEVELOPMENT AND LESSONS FOR THE PACIFIC ALLIANCE

Benedicte Bull

1. Introduction

The Pacific Alliance was formed during Latin America's "growth decade". The period between 2003 and 2013 was one of high economic growth, with only a brief slump in 2008-2009. The economic growth, expansion of Latin American companies (so called *multilatinas*), and Latin America's increased role in the global economy, have made commentators include several Latin American nations into the category 'emerging' nations.

A new trend in Latin America during the growth of decade was that that economic growth was accompanied, not only by a rapid improvement on a number of social indicators and poverty-reduction, but also a modest decline in inequality. This development is often accounted for by pointing to the fact that the 'growth decade' coincided with a political shift towards center-left governments. Out of 49 presidential elections in Latin America in the 2003-2013 period, 22 were won by center-left candidates, and with the exception of Mexico and Colombia, all the large economies in Latin America were governed by center-left governments during most of this period. There were high expectations regarding a transformation towards a more sustainable and equitable development model as a result of this leftward turn, particularly since several of the incoming candidates had part of their support base in social movements advocating for such a shift. Moreover, various new governments launched innovative and ambitious plans for how to shift the focus of development towards human wellbeing in harmony with nature, as for example was expressed by the concept of *buen vivir* (good living) that was central in Bolivia

and Ecuador. However, there is little agreement about how to characterize the development models that are actually emerging, and whether current progress is sustainable, environmentally, socially and economically.

This chapter reviews some key developments in Latin America over the last decade, and will discuss the principal factors behind growth and poverty reduction, as well as the main challenges that Latin America currently faces, including that of sustainable development. It will be argued that one group of countries that have been governed by center-left governments over the last years have adopted different versions of a *developmental regional nationalism*. This is characterized by an increasing direct state engagement in developmental policies, and increasing economic nationalism, but embedded in regional integration and open to trade and investments from abroad. Another group has continued to pursue what could be called market-oriented development policies, including most of the countries belonging to the Pacific Alliance. Both models face significant challenges if current patterns continue. In part, we look towards weaker growth in much of the region, principally due to lower commodity prices. Latin America is likely to experience increased over –exploitation of natural resources and environmental problems, accompanied by increasing social tension. These are issues that any new alliance and development project –including the Pacific Alliance– mmust take increasingly seriously, particularly as the growth decade is coming to an end, and the region is looking towards lower growth-rates.

2. Latin America's Decade of Growth: Achievements, Challenges and Variations

Between 2004 and 2007, Latin America went through a growth period that had not been experienced in the region since the 1970s. The countries of the region had an average annual growth in GDP per capita of more than 6 percent between 2004 and 2007. The economies also rebounded quickly after the financial crisis of 2008; quite another thing from the devastating impact that the financial crises of the 1980s and 1990s had on the region (see table 10.1). However, 2014 signified an end to the patterns, with weaker growth across the region.

Since the beginning of the decade, there were strong sub-regional and country level differences. In the 2003-2010 period, South America grew by 5 percent and Central America 4.3 percent, while Mexico only grew 2.2

percent (ECLAC 2012). The more stable growth-patterns were experienced in Panama, Peru and Chile, but Brazil, Argentina, Colombia, Uruguay, Paraguay and Venezuela also had years of very strong growth (ECLAC 2013a). Also in terms of the down-turn after the 2008 crisis, there were large regional disparities: while Mexico saw a negative growth rate of 6.5 per cent in 2009, Bolivia and Uruguay continued to grow at about 3 per cent the same year. In a historical context it is perhaps not terribly impressive–in the 1960s and 1970s, Latin America also experienced high growth. However, it is a remarkable turnaround from the 'lost decade' of the 1980s and the unstable growth rates of the 1990s.

Economic growth at home was accompanied by an inflow of foreign direct investment (FDI), but also by the expansion of Latin American companies across borders, within Latin America and beyond. Inwards, FDI was 18 times higher in 2012 than in 1990 (approximately 170 versus 9 billion USD), and it showed a steady increase. In terms of FDI as a percentage of GDP, it was about the same in 1998 as it was in 2012 (approx. 4.3 per cent) (ECLAC 2013b). However, the inwards investments of the late 1990s were mainly a result of the foreign acquisitions of state-owned assets in privatization processes. In contrast, FDI in the 2000s was directed towards several different sectors, and a large share was green-field investments in commodities and infrastructure.

Table 10.1

Country	Economic growth (average annual growth in GDP/c)			Total GDP/c 2012 ††
	2004-2007	2008-2009	2010-2012	
Argentina	8.8	4.3	5.9	11 614
Bolivia	4.5	4.3	5.0	2 625
Brazil	4.6	2.2	3.3	11 334
Chile	5.2	1.5	5.5	15 372
Colombia	6.2	1.0	4.7	7761
Costa Rica	6.6	-0.2	4.3	9402
Dom rep	7.4	2.2	4.8	5794
Ecuador	5.1	2.8	4.8	5638
El Salvador	3.5	-0.2	1.9	3795

Country	Economic growth (average annual growth in GDP/c)			Total GDP/c 2012 ††
	2004-2007	2008-2009	2010-2012	
Guatemala	4.4	1.5	3.8	3337
Honduras	6.2	0.9	3.4	2343
Mexico	3.8	-2.9	4.0	10 041
Nicaragua	4.3	1.1	4.8	1757
Panama	8.7	3.5	9.1	9454
Paraguay	4.5	1.4	7.1	3684
Peru	7	3.5	7.0	6811
Uruguay	8.2	4	5.8	14703
Venezuela	11.8	2.3	2.3	12733
Latin-America		1.3	4.2	9501

Another important feature was the expansion of Latin American multinational companies (*multilatinas*) abroad. By 2010, out of the more than 11,100 mergers and acquisitions of companies, more than half involved companies from emerging countries as buyers or targets. During that year, in Latin America, the *multilatinas* represented 17 percent of the total acquisitions, exceeding investments by OECD countries, which represented 12 percent of the total (Santiso 2013, 6-22).

Not only economic measures, such as GDP growth, showed promise; but a number of social indicators also showed positive trends. While 43.9 percent of the population lived below the national poverty lines in 2002, this had dropped to 27.5 percent in 2013.[1] The steepest annual reduction occurred between 2002 and 2008 when it fell from 43 to 33 per cent. Also, levels of extreme poverty dropped significantly, from 19.3 per cent in 2002 to 11.5 per cent in 2013 (ECLAC 2013b). This happened after a steep increase in poverty rates during the 1980s, and a certain leveling out in terms of percentage, there was still an increase in terms of total number of people living in poverty in the 1990s.

1. This is based on statistics from ECLAC which uses national poverty lines.

Peru saw a 54% drop in poverty, while Mexico saw almost no change (from 39.2 per cent to 37.4 per cent) during the same period.[2] Also, Argentina, Brazil and Chile and have more than halved their poverty rates, and a number of other countries have seen significant reductions. It is important to notice, however, that the countries started out at extremely different levels: 77 percent of the population lived in poverty in Honduras 2002, while the corresponding number for Uruguay was only 15 per cent. Moreover, they had seen different degrees of variations. For example, Argentina has historically had much lower poverty levels than those seen in 2002, a year marked by the effects of the devastating economic crisis of 2001, which is an important background for the drop during the growth decade.

Another major achievement was that, for the first time since serious measurements were made, inequality declined across the region during the first decade of the 2000s. From an (unweighted) average of 0.530 in the late 1990s, the Gini coefficient for household per capita income fell to 0.497 in 2010 (Lustig *et al* 2013). Moreover, when the decline in poverty rates slowed down between 2008 and 2012, the decline in inequality continued (CEPAL 2013a). It has occurred in the countries with the highest levels of inequality, as well as those with the lowest, and it has largely brought Latin America back to the levels of inequality it experienced around 1980 (Gasparini and Lustig 2011). However, there were again significant variations across countries. Although different publications conclude somewhat differently due to differences in cut-off lines, it seems that inequality declined most in Venezuela, Argentina, Nicaragua, Ecuador and Bolivia, while the least improvement was registered in Guatemala, Paraguay and Honduras (Lustig et al 2013, CEPAL 2012).

Although there is agreement that these positive trends are due both to economic growth and social policy, there is less agreement about the reasons for the growth and whether current patterns are economically and environmentally sustainable. In order to address that, factors behind the current patterns will be discussed in the following section.

2. The numbers for Argentina are based on national (relative) poverty lines and only based on the urban population (which is 93 percent of the whole population). It should be remembered that the 2002 was a historical peak in poverty levels due to the 2001 economic crisis. There is also some questions about the real poverty levels for the latest years due to controversies regarding the actual inflation.

3. A Stroke of Luck? Changes in the International Political Economy and the Latin American Growth Decade

One argument is that most of the progress is due to favorable global economic conditions. The last ten years have been characterized by a significant increase in the prices and demand for Latin Americas main export commodities. Since around 2000, there has been an annual increase in demand for metals of approximately 30 percent, and the total price index for oil, natural gas and metals more than quadrupled between 2003 and 2011 (UNASUR/CEPAL 2013). As prices increased, so did the pace of the extraction of natural resources. Between 1990 and 2010, the percentage of the global production of three metals (gold, unrefined copper and molybdenum) produced in Latin America doubled, while the production of other metals also rose. As a result, Latin American countries' fiscal income from natural resources has also increased, after a slump in the period before 2003 (UNASUR/CEPAL 2013).

As a result of the commodity boom, the natural resource dependence of the South American economies grew during the first decade of the 21st century. Central America and Mexico continued the trend towards less commodity dependency, while Brazil lay in a middle position, as it both has a sizeable natural resource export sector and significant industry (Ocampo 2008). However, Brazil also experienced increased dependence on commodities over the last decade. The decrease in commodity dependence in Central America and Mexico also had its downside. Much of it was due to the growth of the so called *maquila,* or assembly industry (based on the assembly of imported parts), which experienced grave problems due to competing for US market shares with cheap imports from China from the early 2000s. If we do not consider the *maquila* exports, traditional agricultural products still make up the largest share of Central American exports (CEPAL 2012). The main change is rather that exports as a whole play a much smaller role, as remittances have replaced exports as the main source of foreign income in many countries in Central America.

One main reason for the commodity boom is China's increased role in trade in Latin America. Over the last decade, China has become the main trading partner for Brazil and Chile and among one of the top three for most of the rest of the region (Durán, Lima & Pellandra 2013). In terms of volume, the bilateral trade expanded from US $14.6 billion in 2013 to US $49 billion by 2005, and it surpassed US$ 250 billion in 2012. However, 2012 also saw a steep increase in Latin America's trade deficit with China, from US$150

million to US$ 6.6 billion.[3] This trade deficit is also very differently distributed. Whereas the commodity exporters of South America –particularly the metal exporters Chile and Peru– have run trade surpluses, most of the other countries have imported more Chinese industrial goods than the value of their exports (IDB/INT Comtrade data). Although trade with China is found only to explain one percent of the growth in the four main economies of South America over the last years (Brazil, Argentina, Chile and Peru) (BBVA 2013), the Chinese expansion contributed to the commodity boom, and therefore to the general growth of the region.

Moreover, China has contributed with significant loans and investments and has thus had the effect of decreasing dependence on the United States. As of 2015, China has provided loans worth more than US$ 65 billion to Venezuela over the last years, as well as more than $40 billion in investment commitments; $19 billion to Argentina and $10,2 billion to Ecuador, backed by oil deliveries.[4] Furthermore, it has provided a $10 billion loan to the Brazilian oil company Petrobras for the development of its offshore oil reserves, over $10 billion in acquisitions in the country's petroleum sector, and $1.7 billion in investments in the Brazilian power infrastructure, to mention only some major investments (Ellis 2013). China's lending made up for the drying up of other financial sources after the financial crisis, and has allowed the Latin American countries a measure of independence from the United States as well as from international financial institutions. Since Chinese loans have generally come without preconditions, this has also given the countries of the region a greater 'policy space.'

Latin America has also pursued a strategy of increased regional integration in order to increase independence and policy space and expand trade. From 2000, a number of new integration mechanisms and organizations were established, and old ones rejuvenated. The main new initiatives are the Union of South American Nations (UNASUR), the Bolivarian Alliance for the Peoples of our America (ALBA), the Pacific Alliance and the Community of Latin American and the Community of Latin American and Caribbean States (CELAC). UNASUR was created in 2008 with the aim to bridge the two existing integration initiatives in South America, the Andean Community (CAN)

3. http://en.mercopress.com/2013/05/22/china-latam-trade-expanded-8-in-2012-and-region-s-deficit-jumped-to-6.6bn

4. See the website http://thedialogue.org/map_list for frequent updates on Chinese lending to Latin America.

and the Market of the South (MERCOSUR), and to give it a stronger political mandate, based on the European Union´s model. While making UNASUR operative has been a long process, and the relationship between the CAN and the MERCOSUR countries has not been free of tensions, UNASUR has achieved a significant position in Latin American politics, and intraregional trade has steadily increased, albeit not strongly, over the last decade.[5] In parallel, ALBA was created by Venezuela and Cuba in 2004, later incorporating Bolivia, Ecuador and Nicaragua and four small Caribbean states. ALBA was based on an idea of exchange of goods and services agreed on by the states, rather than having a goal of lifting general barriers to trade to allow for private actors to trade.

The Pacific Alliance is, of course, based on a very different scheme, aimed at a market-based integration, including integration of the stock exchanges, as a means of strengthening growth, and just as importantly, to reap benefits from closer relations with Asia.

As a result of regional integration, intra-regional trade grew only modestly, from approximately 16 to 20 percent of total trade between 2000 and 2010; whereas trade with Asia (including China) quadrupled in the same period (ECLAC 2011). However, it would not be fair to judge the success only in terms of volumes of intra-regional trade. The regional arrangements have particularly incentivized small and relatively poor countries, such as Bolivia and Ecuador, to pursue expansive policies due to cheap oil, loans and investments from neighboring countries. Yet another effect has been to consolidate the differences between the countries pursuing a neo-liberal model (Mexico, Panama, Costa Rica, Chile, Colombia, Peru), and those pursuing a developmentalist regional nationalism (Venezuela, Brazil, Argentina, Bolivia, Ecuador). While the former favors free trade, a minimum of state intervention in the economy, and close cooperation with international financial institutions on macro-economic policy, among the latter, there are various examples of protectionism, state intervention and conflicts over macro-economic policies (perhaps particularly related to the question of how to manage prices).

Regional integration has been complemented by active pursuit of alliances and agreements with countries and regions across the world. Mexico

5. Both CAN and MERCOSUR are now full customs unions, but MERCOSUR has generally pursued a more protectionist policy towards third parties. Due to CAN's association with a neo-liberal free trade idea and its signing of a free trade agreement with the United States in 2006, Venezuela decided to leave it and applied for membership in MERCOSUR, something that it was finally granted in 2012.

and Chile have led the way in the signing of bilateral Free Trade Agreements (FTAs), while Brazil and Venezuela have been more active in signing broader cooperation agreements that include investments as well as loans, trade and other issue areas. Latin America has also been an active player in multilateral organizations. Brazil was a strong proponent of the new agreement of the World Trade Organization (WTO) that was signed in 2013 under the leadership of WTO's newly appointed Brazilian secretary General Roberto Azevedo. Venezuela, on its side, has been an active player in OPEC and OPEC's success in limiting oil production came after an initiative to rejuvenate the organization taken by Venezuela's late president Hugo Chávez in 2000. This has been one of the reasons behind the last decade's high oil prices, from which Venezuela benefitted generously.[6] Thus, while favorable international conditions have played an important role, it is also the case that Latin American countries have actively attempted to affect those conditions. Moreover, it is clear that an increase in exports only explains a small share of the growth. Current growth is increasingly driven by greater internal demand. Therefore, we need also to look at domestic policies in order to understand current patterns.

4. New Developmental Policies and Public Spending

The combination of the international economic conditions and the rise to power of a number of new governments with an inclination towards the center-left of the political spectrum, led to a significant, albeit diverse, shift in social and developmental policies.

One of the most striking changes has been the increase in social spending. This grew from 15.2 percent of GDP in 2000 to 19.2 percent of GDP on average in 2011; as a percentage of total public spending, it grew from an average of 60 to 65 percent. The increase in absolute terms has been much more significant due to the simultaneous relatively high economic growth. Moreover, in the second half of the 2000s, growth in social spending was mostly counter-cyclical: It was driven by policies that were applied to offset various external shocks: the sharp increase in food and fuel prices in 2008, and the global financial crisis (ECLAC 2013a). While most types of social spending increased, what characterized the center-left countries was a stronger

6. Other factors contributing to that was of course the Iraq War and the September 11 attacks in 2001.

increase in direct transfers, including conditional cash-transfer programs, pensions and other types of non-contributive social security spending. There has simultaneously been an increase in efforts to formalize informal work, increase minimum wages and provide public jobs in a form of counter-cyclical Keynesianism. Thus, total public spending has increased from 25 percent in 2000 to 29 percent in 2002.

However, a stronger emphasis on social policies is only one aspect of the developmental policies pursued. The other side of the coin is a renewed emphasis on increasing state revenues, as well as on increasing the role of the state in directing–directly or indirectly–the economy. The level of public investments varies significantly across the region, but saw a particular increase in Venezuela, Bolivia and Ecuador. The main investment increase came from private investors, but they were increasingly supported by national development banks that in 2009 accounted for 30 per cent of total lending to the private sector; in some countries, up to 70 percent. While tax revenues are still low compared to the OECD, they also increased steadily between 2000 and 2010, and Brazil and Argentina now have tax levels comparable to OECD countries (35 and 33 percent of GDP respectively), while countries such as Mexico and Guatemala lag far behind, with approximately 12 per cent, and Venezuela has experienced a drop from around 18 to 14 per cent (ECLAC 2012).

The nationalist aspects of this strategy are particularly strong given the increasing emphasis on building national industries, requiring national content in foreign direct investments (through the use of domestic services and goods), requiring increased return from FDI, particularly increased royalties in natural resource investments; and in some countries –notably Venezuela, Bolivia and Argentina– through nationalization of industry. This bears a resemblance to the developmental strategies once devised by regional organizations such as the CEPAL and the IDB in the 1950s, but has so far failed to really produce a significant structural change. There are also other aspects of the current policies that may give some pause.

5. New Developmentalism and New Extractivism: the Challenges of Sustainability and Structural Change

As the first decade of the 2000s ended, there were significant worrying signs. First, 2012-2013 saw weaker growth in most countries during the preceding years, and the protracted slowdown in Europe and the United

States, as well as weaker growth figures in China, began to be felt. However, more importantly, as argued by several of the region's leading economists, few countries had used the opportunities provided during the 'growth decade' to engender structural change; that is, to shift resources from less to more productive sectors (ECLAC 2012). The old distinction between agriculture and industry as less and more productive sectors is increasingly obsolete, as intensive agricultural production became highly productive in economic terms. Thus, commodity dependency does not necessarily mean low productivity or low technology. The domestic sector that has grown the most is the service sector, and this accounts much more for low productivity than commodity extraction. Nevertheless, a deep breach remained between highly productive sectors and segments and low productive and low-pay sectors and segments. This was increasingly viewed, not only as a barrier to continued, sustained growth, but also to further inequality reduction, due to high wage differentials between different sectors (ECLAC 2012).

Moreover, the gap between North, Central and South America became increasingly obvious. Mexico and parts of Central America (notably El Salvador, Guatemala and Honduras) that remained highly dependent on the US economy struggled with volatile growth, weak performance in terms of poverty reduction, and as a deep penetration by organized crime. Although South America's performance varied greatly, commodity dependence gave them more policy space (ironically, as this historically has been viewed as a main vulnerability of the Latin American economies), that in many countries were used to creating buffers against external volatility. However, some of the leftist countries, notably Venezuela and Argentina, were increasingly characterized by economic mismanagement and high inflation, leading to increased poverty in Venezuela.[7]

Furthermore, one of the greatest worries of the development patterns in Latin America relates to the environment. There are two principal reasons. The first is the increase in natural resource extraction, with related pollution problems and increased competition for land and water resources. As noted above, the extraction of fossil fuels, metal ores, industrial and construction minerals and biomass in Latin America has rapidly grown. An analysis attempting to calculate the total extraction of natural resources found that in 1970, the total extraction of materials was 2.3 billion tons; in 1980 it was 3.5

7. There is no agreement on the actual poverty levels in Argentina. Therefore, we do not really know whether the same is true for Argentina.

billion tons; and in 1990, 4.3 billion tons. In the period between 2000 and 2008, regional extraction rose from 6.1 to 8.3 billion tons –a 36% increase. Analyses of individual countries found, for example, that after a relatively steady phase of annual extraction in Argentina of around 400 million tons of material from 1970 to 1997, this increased to almost 700 million tons annually in the period from 1998 to 2008. In Ecuador, annual material extraction tripled, from 30 million tons in 1970 to 105 tons in 1996; and after a dip it rose to 118 million tons in 2006 (ENGOV 2013).

This is not only an unsustainable pace of extraction of mining and other non-renewable resources; it also puts a strain on water resources and pollutes the soil, and increases the skewed distribution of land. Accordingly, there is a steep increase in conflicts over natural resources. As a result, according to the Observatory of Mining Conflicts in Latin America (OCMAL), there are currently more than 195 active conflicts due to large-scale mining in the region. Peru and Chile lead the list, with 34 and 33 conflicts respectively, followed by Mexico with 28, Argentina with 26, Brazil with 20 and Colombia with twelve.

Also, oil extraction provokes conflicts across the region due to oil spill and pollution. The largest and most well-known case is Chevron-Texaco's dumping of billions of gallons of toxic wastewater into the Ecuadorian rainforest in the Amazon region between 1964 and 1992, creating an environmental disaster of enormous dimensions. This, and other blatant abuses by multinational companies, aided by local elites, was among the factors that led to the rise of social movements which eventually contributed to the rise to power by several center-left governments, including those of Rafael Correa in Ecuador, Evo Morales in Bolivia and Luis Inácio Lula da Silva in Brazil. However, once in power, they have maintained quite contradictory practices. They have had a more open dialogue with the environmental and other social movements. For example, in Brazil, a major effort was made to reduce deforestation in the Amazon; in Ecuador, new regulations were introduced to make oil extraction more sustainable; and Bolivia set forth to strengthen small-scale, sustainable agriculture. However, the same governments have made economic growth a main priority and simultaneously gone back on their early promises, such as respecting indigenous territories and prohibiting genetically modified organisms (Gudynas 2011, Andrade and Zenteno 2014). Therefore, they are increasingly in conflict with social movements that were previously among their supporters (Bull 2013).

While we find these conflicts across the ideological spectrum, it is a fact that trade with Asia up until now has consisted almost completely of exports of

commodities from Latin America to Asia –mainly China–and import of light industrial goods. This is the trade that the Pacific Alliance aims to position its member countries to benefit the most from. However, it is also the activity that is the source of increasing environmental havoc and social conflicts; an issue that the Pacific Alliance needs to take seriously if it is to succeed.

Whereas land and resource conflicts abound in the rural areas, there is a second main challenge related rather to urban consumption patterns. This is the much celebrated rise of a new Latin American middle class (Ferreira *et al* 2012). The new middle class consists of people that previously lived below the poverty line, but who are now able to buy new consumer goods, and possibly even a car. While generally a good sign, this also put a strain on the use of energy and water, urban infrastructure and waste systems. Latin America is found to be highly dependent on energy for increase in GDP per capita. For example, Barreto and Campo (2012) find that energy use increases by 1 percent for a 0.40 percent increase in GDP, and that this is largely due to the high energy dependence of the service sector, which accounts for almost 60 percent of the region's GDP. While a number of policies have been implemented to increase the supply of energy, among other things, through regional integration projects discussed above, the popularity of current governments rests to such an extent on the rise of living standards among popular sectors that limitations to consumption beyond limited schemes such as restricting water consumption in specific areas are a hard sell.

6. Conclusion

Latin America has recently come out of a decade of significant positive changes. Economic growth, innovations in social policy and reduced poverty have gone hand in hand with a shift in international alliances leading to stronger regional integration and a decreased dependence on the United States. At the center of these developments has been the return of the state as a key development actor in many countries. Through the state, new social policy programs have been created, and old programs have been expanded. The states have supported large national companies that have expanded across borders, and have made investments in national industrial upgrading. Moreover, the states are driving new forms of regional integration and international alliance building. The results are not only improvement on economic indicators. As *Latinobarómetro* has consistently shown, Latin American's view of

their own situation is also improving, and they are generally more optimistic regarding the future (*Latinobarómetro* 2013). In many respects, the Latin American experience of the last decade is a classical process of development. However, development is never without conflicts and disadvantages. The rapid development has generated conflicts with local communities that historically have been weakly incorporated into the national states. Rapid urban development has occurred at the expense of poor neighborhoods and engendered new congestions and urban challenges. And when the state set forth to ensure simultaneously state building and poverty reduction, the losing side has very often been the environment. Thus, as the Latin American economies 'emerge,' so do conflicts over use of natural resources, economic distribution and management of the increasing state resources. It should be a high priority for the Pacific Alliance to take these issues seriously and to consider environmental and social demands when forming strengthened relations to Asia and between the Latin American countries.

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THE PACIFIC ALLIANCE IN ASIA-PACIFIC: PARALLELS AND LEGAL LIMITATIONS TO INTERREGIONAL COOPERATION

Juan José Ramírez Bonilla

On April 28, 2011, through the Lima Declaration, the presidents of Chile, Colombia, Mexico and Peru made public the institutionalization of the Pacific Alliance (PA). As was stated in the declaration, the heads of state wished to consolidate the experience of the Pacific Arc "as a space for dialogue and convergence, as well as a mechanism for political dialogue and projection towards the Asia-Pacific region."[1] The preamble of the text highlights the existence of free trade agreements between the four governments which are involved in the project, which would be a facilitating base for "the creation of an area of deep integration ... which will encourage regional integration, as well as increased growth, development, and competitiveness within our economies."[2]

In just four years, the project has achieved a notoriety which was hardly expected by its promoters. Indeed, as of the beginning of June 2015, 32 governments have become observers of the young regional organization, which constitutes an unprecedented case of regional integration; thus, in relation to the member bodies, the observers represent a figure of 800%. However, given that the "Asia-Pacific" is the target region of the PA, we are able, first of all, to evaluate it according to the meaning that we grant to said region:

- In a strict geographical sense, "Asia-Pacific" includes the Asian Pacific coastal countries; only China, Korea, Japan and Singapore (12.5% of observer states) in the list of observers belong in the scope of projection foreseen by the AP's founders.

1. Pacific Alliance, *Declaración de Lima sobre la Alianza del Pacífico (Lima Declaration on the Pacific Alliance)*, Lima, Peru, April 28, 2011, http://alianzapacifico.net/documents/AP_Declaracion_Lima_I_Cumbre.pdf

2 Idem.

– In broader political terms, such as those of the Asia Pacific Economic Cooperation forum (APEC), "Asia-Pacific" also includes Canada, the United States, Australia and New Zealand (12.5% of observers) in the list of observers belonging to the target region.

Based on these geographical and / or political criteria, we can further discern the notoriety that has been reached: if the central objective of the project's founders were the Asian Pacific countries, success has been extremely limited, given that only 12.5% of observers are from the Asia-Pacific region. However, when the target area is defined in broad political terms, the achievements are more marked, with 25% accumulated from the total observers.

Certain countries deserve special mention: Costa Rica, Ecuador, El Salvador, Guatemala, Honduras and Panama (which make up 18.75% of observer nations); because, bordering the ocean as they do, they are natural candidates to become members states of the PA and, ultimately, they are also part of the target region, as it is defined in the broad political sense.

In any case, 56.25% of the observer states come from areas outside of the Pacific region; among these, the predominant countries are European (31.25%), followed by other Asian countries (9.38%) and by an African one (3.12%).

Cuadro 1. Observer States Of The Pacific Alliance

America	Europe	Pacific Asia
Canada	Germany	China
United States	Belgium	Korea
Paraguay	Spain	Japan
Dominican Republic	Finland	Singapore
Trinidad and Tobago	France	
Uruguay	Italy	Other Asian Counties
Costa Rica*	Netherlands	India
Ecuador	Portugal	Israel
El Salvador	U.K.	Turkey
Guatemala	Switzerland	Oceania
Honduras	Africa	Australia
Panama*	Morocco	New Zealand

* Candidate for membership in the PA
Source: own source, with information from information from the Pacific Alliance: http://alianzapacifico.net/paises/paises-observadores/

Given this situation, one wonders what aroused such great interest among the governments of countries located in regions outside the strategic scope of the PA, as well as its limited success within the governments of countries the Asia-Pacific region. On the other hand, we have shown that the inter-regional process of integration has been extremely limited in the case of the Pacific Alliance, that its weight in the gross world output and overall world trade is low, and that its participation in global demand is very small compared to other regional markets.[3] Given these facts, our text is centered on the idea that the greatest reason for interest in the Pacific Alliance is not economic in nature, but political. To demonstrate this political character we shall analyze the political and ideological background of the governing principles dictating membership in the Pacific Alliance, contrasting, in the first part, the Democratic Clause of the European Union-Mexico Global Agreement and, in the second part, with the major texts of the Association of Southeast Asian Nations (ASEAN). Finally, In the third part, we will show that the parallels in terms of the acceptance of democratic principles and human rights cannot converge, because while the ASEAN governments maintain as a legal vector a principle of non-intervention in the affairs of other states, the governments of the Pacific Alliance lean towards intervention when they speak of the promotion of democracy and human rights.

We must recall the express will of the founders of the Pacific Alliance's political leaders to conceive of the alliance "as a space for dialogue and convergence as well as a mechanism for political dialogue and projection into the Asia-Pacific region," as this statement makes explicit and highlights the regional political vocation of the project. However, it is worth remarking that:

- The PA has been conceived as a mechanism for political dialogue in two ways: first, among its members, to be defined as "a space for dialogue and convergence;" and second, between its members and the partners belonging to "Asia-Pacific."
- The geographical projection of the PA has not been on "Asia-Pacific," but rather on Europe and America, as evidenced by the predominance of European and American observers on the Asian region in general, and the Asian Pacific in particular.

3. José Luis León Manríquez and Juan José Ramírez Bonilla, *La Alianza del Pacífico. Alcances, competitividad e implicaciones para América Latina* (The Pacific Alliance. Reach, Competitiveness and Implications for Latin America), Friedrich Ebert Stiftung, Mexico City, 2014.

In practice, the PA acts as a potential mechanism for interregional political dialogue in a space that transcends the target area initially proposed by the founders. The interesting aspect of this peculiar situation is that interest in the project of the PA has been higher in America and Europe than in the Asia-Pacific region.

1. On Democratic Processes and Respect for Human Rights

A constraint imposed by the European Union for the negotiation of a bilateral trade agreement with Mexico was the inclusion of a democracy clause; thus, Article 1 of the Global Agreement between the European Union and Mexico states:

> "A respect for democratic principles and fundamental human rights as they are set forth in the Universal Declaration of Human Rights underpins the domestic and international policies of the Parties and constitutes an essential element of this Agreement."[4]

The United Nations Convention on Human Rights is based, as is stated in the above text, on the protection of these rights in both domestic and international political practice of the authorities that have subscribed to it; it is therefore a voluntary and unilateral show of respect to the extent that there is no supranational authority capable of imposing adherence to the Universal Declaration of Human Rights. Furthermore, voluntary and unilateral respect must be understood in the framework of the United Nations Charter; according to this document, the organization offers its members six fundamental principles: 1. Sovereign equality of all its Members; 2. Compliance in good faith to the obligations incurred ... under this Charter; 3. Settlement of international disputes by peaceful means; 4. Refraining from the threat or use of force against the territorial integrity or political independence of any State; 5. The obligation to provide to the Organization every assistance in any action it takes in accordance with the present Charter; 6. Abstention by the United Nations of interventions in matters which are essentially within the domestic jurisdiction of any State.[5]

4. Global Agreement Between the European Union and Mexico, Article 1; cited by Maureen Meyer, "Challenges and Possibilities in the Use of the Democratic Clause. Experiences of Civil Society in the Global Agreement Between the European Union and Mexico"; available at: http://fdcl-berlin.de/fileadmin/fdcl/maureen052004.pdf

5. Idem, article 2.

The spirit both of the Universal Declaration of Human Rights and the United Nations Charter is the voluntary adoption of the principles of both conventions, without attempting to influence the attitude of third parties who adhere to these principles; from another perspective, we can say that the unilateral practice of respect of the norms formulated by the international organism is based on the self-determination of governments and the principle of non-intervention in the affairs of third States. It is in such a context that the Democratic Clause of the Agreement of the European Union and Mexico acquires its full meaning: both political entities are simply undertaking to respect democratic principles and human rights through their particular domestic and international political practices, while refraining from intervening in the internal affairs of the other party.

In the Framework Agreement of the Pacific Alliance, the participating governments also clearly establish the political framework of the integration project. Article 2 establishes the mandatory principles for participation in the Pacific Alliance: "a. the rule of law, democracy, and the corresponding constitutional order; b. the separation of the branches of government; and c. the protection, promotion, respect, and guarantee of human rights and fundamental freedoms."[6]

The existing parallel between the Democratic Clause of the Global Agreement Between the European Union and Mexico and the Pacific Alliance Framework Agreement (PAFA) is evident. That parallel, in our opinion, at least partly explains the great interest generated by the project among American and European governments. Indeed, except for Ecuador and Uruguay, where governments could be categorized as belonging to the Latin American "left wing," the other observer governments from America and Europe claim, at least in declarative terms, to espouse democracy and human rights. Hence their interest in participating in a space for dialogue and convergence based on a common ideological-political base.

Now, in the next section we discuss the parallels which also exist between the PAFA and the basic texts of the Association of Southeast Asian Nations (ASEAN), which show that the low interest shown by governments in the Asia-Pacific region lies in the factors preventing their parallel developmental lines from converging.

6. Pacific Alliance, *Framework Agreement to the Pacific Alliance*, Paranal, Antofagasta, Republic of Chile, June 6, 2012; available at: http://www10.iadb.org/intal/intalcdi/PE/2013/11593.pdf

2. Legal Parallels Between PAFA and the ASEAN Texts

Regarding the mitigated government interest in Asia-Pacific, we find that the group of observers from the PA comprises, in addition to China, three of the four countries in the region considered by the International Monetary Fund to be developed countries: Korea, Japan and Singapore; and the four observers from Asia-Pacific are also demanding democracy as the best form of government, not under generic forms, but through their specific national context and marked by the specific moral norms of Asian societal expressions.

On the other hand, we should also note that ASEAN is not only involved in five of the ten economic integration processes currently underway or under negotiation in the Pacific region (Table 2), but, as will be discussed below, it also plays an important political role in defining the new institutional framework of Asia-Pacific; consequently, to the members of the AP, the projection on "Asia-Pacific" must necessarily focus on the ASEAN. However, among ASEAN members, only Singapore participates in the group of observers of the PA. The little interest shown by ASEAN is largely is explained partly by the parallels between the Democratic Clause of the Global Agreement between the EU and Mexico, the Pacific Alliance Framework Agreement, and the fundamental texts of ASEAN; and on another side, by the factors preventing the convergence of said parallels.

To better understand the parallels, we must recall the experiences of the ASEAN countries in the legal field; in fact, in 1967, the governments of the Philippines, Indonesia and Malaysia just recently overcame the conflict known as *Konfrontasi*, which was provoked by the decision by the British authorities to grant political independence to its last colonial strongholds in Southeast Asia: Brunei, Sabah, Sarawak and Singapore would be under the sovereignty of the Federation of Malaya and become the modern Federation of Malaysia. Due to the influence of left-leaning domestic political factions, Brunei withdrew from the project. The Republic of the Philippines, in turn, claimed sovereignty over part of the territory of Sabah, arguing that, it had once been ceded by the Sultan of Brunei to the Sultan of Sulu. Indonesia claimed sovereignty over the three territories located on the island of Borneo because in the past, they had formed part of the Mahapahit Empire.

The military confrontation in Southeast Asia occurred in an escalating regional context marked by the intensification of US military intervention in Indochina, which sought to limit the spread of communism in the region; thus, for governments in Southeast Asia it was important to restore regional

harmony in order to avoid external interference by pro-communist or pro-capitalist factions; so that, thanks to the good offices of the Thais, government representatives from the Philippines, Indonesia, Malaysia, Singapore and Thailand, in August 1967, established the Association of Southeast Asian Nations. These nations were very clear about the objectives and the context in which the new organization emerged: the countries of Southeast Asia were "determined to ensure their own stability and security regarding any form or manifestation of outside interference, in order to preserve their national identities, according to the ideals and aspirations of their peoples. In this part of the Bangkok Declaration, the principle of non-intervention in the affairs of other States stands out, and it pointed both to the participants in the Association and to the participating factions in the military confrontation in Indochina–aware of a growing danger of the spread of conflict in the region, the signatories of the Declaration emphasized that "all foreign bases are temporary and remain only with the express permission of the concerned countries, and will not be used either directly or indirectly to subvert the national independence and freedom of the States in the area." Of the five items comprising the Bangkok Declaration, the first is dedicated to the establishment of the ASEAN, while the second provides seven objectives and principles of the Association; for the purposes of our analysis, the second part is especially interesting: "the promotion of regional peace and stability through a continuing respect for justice and the rule of law in all relations between countries in the region, according to the principles of the United Nations Charter."[7]

In a world where the hegemonic powers used to impose their interests on the international rule of law, ASEAN converted the principles of the United Nations Charter into the leitmotif of the major collective decisions and of institutional order built by the Asia-Pacific Association. Thus, in 1971, and during the most acute phase of US military intervention in Indochina, ASEAN members signed the Declaration on the Zone of Peace, Liberty and Neutrality. The third point recovered the principles of the UN Charter: "... the valuable aims and objectives of the United Nations, particularly as they regard a respect for the sovereignty and territorial integrity of all States, refraining from all forms of threat and the use of force, and the peaceful settlement of international disputes, equal rights, self-determination and non-interference in the affairs of States." Further afield, the associated governments came again upon one

7. ASEAN Secretariat, Bangkok Declaration, Bangkok, Agust 8, 1967, available at: http://www.asean.org/news/item/the-asean-declaration-bangkok-declaration

of their top concerns: "the right of each State, be it large or small, to direct its own existence, free from external interference in its internal affairs, insofar as this interference would adversely affects its freedom, independence and integrity." The essential content of the statement is summed up in three short lines, through which the five governments affirmed their determination to "initially exert all necessary efforts to obtain recognition and respect for Southeast Asia as a Zone of Peace, Liberty and Neutrality, free from any form or manner of interference by outside powers."[8]

Ten months after the official end of the US military intervention in Vietnam, the ASEAN members gathered to issue a new regional convention: the Treaty of Amity and Cooperation in Southeast Asia (TAC). The central theme of the TAC is outlined in the third part, "the dispute or disputes between [the] countries should be regulated by rational, effective and sufficiently flexible procedures, avoiding negative attitudes which may hinder or jeopardize cooperation." The forward-thinking vision of the of the TAC signatories is now obvious: once the extra-regional military forces had been removed, the differences between radically different political regimes (Cambodia, Laos and Vietnam with socialist systems; Brunei, Malaysia and Thailand with monarchies; the Philippines, Indonesia and Singapore with Republican systems; and Myanmar's military junta) required a flexible treatment in order to ensure coexistence.

The essence of the TAC is contained in the first four chapters of the text; the first is devoted to the objectives (Article 1) and principles of the treaty (Article 2), which are again explicitly retrieving the principles of the United Nations Charter. The theme of the second chapter is friendship, and consists of a single article which upholds the good faith of the signatories in assuming the obligations contained in the TAC. The third chapter deals with cooperation, and the subject is treated in nine articles expounding on various aspects of said cooperation. The fourth chapter develops the theme of peaceful settlement of disputes; the central aspects of which are: the establishment of a High Council charged with mediating in disputes between members of the Association, the responsibilities of the Council and the obligations of participants in a dispute.[9]

8. ASEAN Secretariat, *Zone of Peace, Freedom and Neutrality Declaration*, Kuala Lumpur, November 27, 1971, http://www.aseansec.org/1215.htm

9. ASEAN Secretariat, *Treaty of Amity and Cooperation in Southeast Asia*, Bali, February 22, 1976; available at: http://www.asean.org/news/item/treaty-of-amity-and-cooperation-in-southeast-asia-indonesia-24-february-1976-3

With the TAC, the Association strives to achieve self-sufficiency in resolving disputes among its members, on the basis of principles of good faith and acceptance of the principles of international law contained in the United Nations Charter.

The signing of the Declaration of ASEAN and the TAC, over time, became the necessary condition for becoming a member of ASEAN; in the twenty years that followed, thanks to the flexible attitude and respect for the principle of non-intervention in the internal affairs of other States, the Association eventually came to include all governments in the region: Brunei (1984), Vietnam (1995), Laos and Cambodia (1997), and Myanmar (1999). East Timor gained political independence in the twenty-first century and is now a candidate for membership in the Association; Papua New Guinea has also signed the TAC and has observer status.

As if this were not enough, the political influence of the ASEAN grew, thanks to various forums for dialogue and consultation: the ASEAN Regional Forum (ARF), created in 1994 to discuss regional security issues and to define and implement mechanisms of preventive diplomacy; currently, there are 27 governments participating in the ARF.[10]

In 2004, participants in the ASEAN+3 Summit decided to institutionalize a new space for dialogue, named the East Asia Summit (EAS), and including the governments of Australia, India, and New Zealand. The first meeting of the EAS was held in 2005; in 2011, Russia and the United States also joined the EAS; US delay was due to doubts in signing the TAC, which is considered a requirement for participation in the new regional mechanism for political dialogue. According to the Declaration of the 9th meeting of the EAS, this is understood as:

> …a forum run by leaders for strategic dialogue and cooperation in economic and social policy issues, security, and regional importance, as well as a range of complex challenges for the region. We reiterate our commitment to the mandate of the EAS to increasing cooperation in priority areas; namely, finance, environment and energy, education, global health and pandemics, management of natural disasters and ASEAN connectivity. Even more, we value highly the

10. The 10 member governments of ASEAN, East Timor as a candidate to ASEAN membership, Papua Nueva Guinea as an ASEAN observer, ten dialogue partners of ASEAN (Australia, Canada, China, the European Union, India, Japan, New Zealand, South Korea, Russia and the United Statess) as well as North Korea, Mongolia, Pakistan, Bangladesh and Sri Lanka. Australian Government, Department of Foreign Affairs and Trade, ASEAN Regional Forum; available at: http://dfat.gov.au/international-relations/regional-architecture/asean/Pages/asean-regional-forum-arf.aspx

role played by the EAS in addressing these issues of common concern and to maintain peace, stability and economic prosperity in Eastern Asia.[11]

In Table 2, we see that, for members of the ASEAN, the Treaty of Amity and Cooperation is the legal basis for the institutional framework promoted by the Association; indeed, of the 29 countries included in the list, only Canada has not signed the TAC, even though it is a dialogue partner and participates in the ARF; Brazil, in contrast, is the latest signatory to the TAC, but is not involved, thus far, in any instance of dialogue. As has been previously mentioned, East Timor is a candidate for membership, while Papua New Guinea has had observer status since 1989, when it signed the TAC.

The most important highlights of Table 2 are as follows:

First, we must draw a contrast between the attitude of the Chinese and US governments: the Chinese government was the second ASEAN non-member to sign the TAC, along with the Indian government, on October 2003; further on, the US was the third to last to sign it, on July 2009. Undoubtedly, the signing of the TAC by the two competing powers in the Pacific region has been a contributing factor to the legal certainty of all ASEAN members; a certainty that is based, as is stated in the texts of the Association, on articles of good faith in the governments in accepting and implementing the international rule of law.

Second, the dialogue partners of ASEAN and the ARF members are marked by the diversity of their geographical origins; this point is important, because it highlights the extra-regional commitment agreed to in these mechanisms for dialogue and the convening power of ASEAN to bring the United States, the European Union, China, Russia and India together to discuss regional security issues.

Third, the East Asia Summit and the FTAs show us two complementary dimensions of the integration process currently underway between Southeast Asia, East Asia, and Oceania. Though it is true that, the exception in the EAS is the United States; it is also a fact that, being essentially a political forum, we cannot forget that both the TPP negotiations conducted by the US government and the shift towards the Pacific region in the foreign policy of the Obama administration have had as a main objective the isolation of China. Therefore,

11. ASEAN Secretariat, *Chairman's Statement of the 9th East Asia Summit*, Nay Pyi Taw, Myanmar, November 13, 2014; available at: http://www.asean.org/images/pdf/2014_upload/9th%20EAS%20Chairman's%20Statement%20(Fnial).pdf

if Americans have abandoned their traditional policy in terms of the containment of China, the political representatives of Southeast Asia have striven to use the EAS as a containment mechanism of the great powers: the United States, China, Russia, the European Union and India.

Fourth, the main existing free trade agreements have so far been of a bilateral nature, and are focused on ASEAN, and reaffirm the trend towards inter-regional integration in Southeast Asia and Eastern Oceania. To the American whim of isolating China by the TPP, Asian governments have responded with negotiations for the Regional Comprehensive Economic Partnership among the ten members of ASEAN, plus Australia, China, Korea, India, Japan and New Zealand.

Table 2. Asean And Its International Partners

	MEMBERSHIPS					
	TAC	ASEAN	Dialogue Partners	ARF	EAS	ALC
Indonesia	24-feb-76	X		X	X	X
Malaysia	24-feb-76	X		X	X	X
Philippines	24-feb-76	X		X	X	X
Singapore	24-feb-76	X		X	X	X
Thailand	24-feb-76	X		X	X	X
Brunei	07-ene-84	X		X	X	X
Papua New Guinea	05-jul-89			X		
Laos	29-jun-92	X		X	X	X
Vietnam	22-jul-92	X		X	X	X
Cambodia	23-ene-95	X		X	X	X
Myanmar	27-jul-95	X		X	X	X
Popular Republic of China	08-oct-03		X	X	X	X
India	08-oct-03		X	X	X	X
Japan	02-jul-04		X	X	X	X
Pakistan	02-jul-04			X		
South Korea	27-nov-04		X	X	X	X
Russia	29-nov-04		X	X	X	

	MEMBERSHIPS					
	TAC	ASEAN	Dialogue Partners	ARF	EAS	ALC
New Zealand	25-jul-05		X	X	X	X
Mongolia	28-jul-05			X		
Australia	10-dic-05		X	X	X	X
France	20-jul-06					
East Timor	13-ene-07			X		
Bangladesh	01-ago-07			X		
Sri Lanka	01-ago-07			X		
North Korea	24-jul-08			X		
United States	23-jul-09		X	X	X	
European Union	12-jun-12		X	X		
Brazil	17-nov-12					
Canada			X	X		

Sources: Wikipedia, Treaty of Amity and Cooperation in Southeast Asia
https://en.wikipedia.org/wiki/Treaty_of_Amity_and_Cooperation_in_Southeast_Asia

Brazil Government, Ministry of Foreign Affairs,
Letter of Accession to the Treaty of Amity and Cooperation in Southeast Asia

http://www.itamaraty.gov.br/index.php?option=com_content&view=article&id=9338:letter-of-accession-to-the-treaty-of-amity-and-cooperation-dilma-rousseff-president-of-the-federative-republic-of-brazil&catid=42&lang=en-GB&Itemid=718

Finally, it is necessary to insist on the fact that this is a group of institutions carrying out multidimensional cooperation, which is based on the legal certainty given by the signing of the TAC. In that sense, we affirm the existence of a legal parallel between the norms contained in the Pacific Alliance Framework Agreement (PAFA) and the principles of international law claimed by ASEAN in its basic texts; however, just as parallel lines never cross, the legal content of PAFA does not converge with the TAC; the reason for this lack of convergence is the principle of non-intervention in the affairs of other states which is omnipresent in the texts of the ASEAN but absent in those of the PAFA.

3. Legal Divergence Factors in PA-ASEAN

While the lines of force in the texts of the ASEAN is the principle of non-intervention in the affairs of other states, the FAMP, through paragraphs **a** and **b** in Article 2, raises the member governments of the PA to the rank of judges ruling in deference to the principles of representative democracy; furthermore, in paragraph **c** they are portrayed as promoters of human rights and the fundamental freedoms, and that it is stated that this promotion is only understandable as an intervention in the affairs of those who aspire to be members of the Pacific Alliance. In this regard, it is notable that there is a yawning gap between the respect for the international rule of law proclaimed by ASEAN and, on the other hand, the proposal modeled on US foreign policy to promote democracy and human rights; this promotion implies, by necessity, interference in the affairs of other states, which violates the basic rules of international law as they have been formulated in the United Nations Charter. It is to this fact one can directly correlate to the lukewarm interest of the member countries of ASEAN in the PA project.

Though it is true that, the members of the two regional organizations have taken the first steps towards forging closer ties, official statements hint at very limited progress so far. In fact, on September 26, 2014, the Mexican Ministry of Foreign Affairs (SRE) announced that it was hosting the First Ministerial Meeting of the Pacific Alliance-ASEAN in New York, with the General Assembly of the United Nations as a backdrop. The Ministry's statement was brief and only mentioned that "dialogue between the Pacific Alliance and ASEAN was positive. The Ministers agreed to find specific areas of cooperation in the near future and continue their discussion in subsequent meetings."[12] Then, on May 25, 2015, in Jakarta, a second meeting was held, which everything indicates was a result of a request by the Pacific Alliance to ASEAN. In fact, the Permanent Committee of Representatives to ASEAN (PCR) and the Ambassadors of the Pacific Alliance accredited to Jakarta, led by Mexican official Socorro Flores Liera:

> "... Had a fruitful exchange of views on the structure and the work of their respective organizations. The PCR congratulated the Pacific Alliance on

12. Ministry of Foreign Affairs of Mexico (*Secretaría de Relaciones Exteriores*), Ministerial Meeting of the Pacific Alliance and the Association of Southeast Asian Nations in New York, Mexico City, September 26, 2014, http://en.sre.gob.mx/index.php/archived-press-releases/2742-ministerial-meeting-of-the-pacific-alliance-and-the-association-of-southeast-asian-nations-asean-in-new-york

> the remarkable achievements in regional integration in the four years since its establishment and noted the interest of the Pacific Alliance in having a better understanding of the ASEAN's experiences in regional integration and community building.
>
> "Both sides recognized the potential benefit of forging economic ties and agreed to explore cooperation in areas such as trade, investment, agriculture, energy, logistics, SMEs, financial services and tourism. [Participants in] the meeting also agreed to explore other areas [for cooperation] such as education, culture and sports."[13]

In other words, it remains be defined which areas will be fruitful for convergence of inter-regional cooperation. In any case, the most important point is the keen interest of the Pacific Alliance in fully understanding the experiences of ASEAN. For our part, we consider it necessary that the current leaders of the Alliance be aware that the content of Article 2 of the PAFA was determined by the ideological differences between the "Left" and "Right" governments of Latin America, during the transition from the twentieth to the twenty-first century; in 2011, the coincidence of the four "Right-wing" governments of Chile, Colombia, Mexico and Peru made it possible to institutionalize the Pacific Alliance, parting from the distinction of principle made in Article 2 of the PAFA. However, the four countries have experienced political upheavals and the content of the aforementioned article could become a straitjacket that, sooner or later, might hinder the relationship with ASEAN and/or with other governments in Pacific Asia. For the Alliance, therefore, it is imperative to review the conditions of membership based on a flexible attitude towards the governments of the Pacific and Latin America and on the highest respect for the principles of international law formulated in the United Nations Charter. For the Mexican government, the task would be facilitated by the fact that these principles are already included in the Constitution of the United Mexican States; in fact, on May 11, 1988, paragraph X of Article 89 was amended to define the nation's guiding principles for foreign policy:

X.- To direct foreign policy and celebrate international treaties which are subject to the approval of the Senate. In conducting such a policy, the Head of the Executive Branch shall observe the following guiding principles: the self-determination of the people; non-intervention; the peaceful settlement of

13. Association of Southeast Asian Nations, ASEAN, *Pacific Alliance to Explore Potential Areas of Cooperation*, Jakarta, May 26, 2015; available at: http://www.asean.org/news/aseansecretariatnews/item/aseanpacificalliancetoexplorepotentialareasofcooperation?tmpl=component&print=1

disputes; the prohibition of threats or the use of force in international relations; the legal equality of the States; international cooperation for development; and the struggle for international peace and security.[14]

However, on June 10, 2011, under the administration of President Felipe Calderón, the Mexican Congress introduced new changes, in section X of article 89, which are marked in bold in the following passage:

> X. To direct foreign policy and celebrate international treaties, as well as ending, denouncing, suspending, modifying, amending, withdrawing reservations to, and issuing interpretative statements upon the same, which are subject to the approval of the Senate. In conducting such a policy, the Head of the Executive Branch shall observe the following guiding principles: the self-determination of the people; non-intervention; the peaceful settlement of disputes; the prohibition of threats or the use of force in international relations; the legal equality of the States; international cooperation for development; and the struggle for international peace and security.[15]

Thus, the administration of Felipe Calderón Hinojosa maintained the continuity of the foreign policy of his predecessor, which was based on the promotion of democracy and human rights. The essence of the end of Section X of Article 89 retaken in Article 2 of the Framework Agreement of the Pacific Alliance: "c. The protection, promotion, respect for and guarantee of human rights and fundamental freedoms." However, both the 2011 amendments to the Constitution of the United Mexican States and the PAFA mark a blatant contradiction between "the respect, protection and promotion of human rights;" with this, the Mexican government and associated governments of the Pacific Alliance reserved the right to discriminate, positively or negatively, among other States, thus ignoring the principles of legal equality, self-determination and non-intervention in the affairs of other States.

The approach to the ASEAN governments or to the participants in the institutional framework which is governed by the Association's legal principles will be possible if, and only if, the Mexican government and those of the

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14. *Diario Oficial de la Federación* (Official Journal of the Federation), *Decree by which Section X of Article 89 of the Political Constitution of the United Mexican States is Reformed;* Mexico City, May 11, 1988; available at: http://dof.gob.mx/nota_detalle.php?codigo=4735026&fecha=11/05/1988

15. *Diario Oficial de la Federación* (Official Journal of the Federation), *Decree by which the title of Chapter I of Title I is amended, and various articles of the Political Constitution of the United Mexican States are reformed*, Mexico City, June 10, 2011; available at: http://dof.gob.mx/nota_detalle.php?codigo=5194486&fecha=10/06/2011

Pacific Alliance renounce the promotion of human rights and freedoms, to return to the spirit of the United Nations Charter and the EU-Mexico Global Agreement; that is, to accept the unilateral and voluntary practice contained in the norms of international law, to respect democratic principles and human rights as they define and implement their foreign policy.

4. Conclusions

We have seen that the Pacific Alliance is faced with two contradictory situations whose outcome will determine the political future of said regional project. The first of these contradictions highlights, on one hand, the mitigated interest of the governments of Pacific Asia, the target region for rapprochement with the PA; and on the other, the attention it has received from European and American governments. The second contradiction is based on the limited nature of the intra-regional integration process and in the organism's potential to become a true mechanism for inter-regional political dialogue–a bridge between America, Europe and Pacific Asia.

Resolving both contradictions will determine the capacity of the governments of the Pacific Alliance to connect with their counterparts in Pacific Asia. In immediate, economic terms, this approach seems difficult, to the extent that the developing countries of both shores differ and would not seem to complement each other; and insofar as economic competition will surely mark their relationships. Actually, in the current context, the political arena would seem to be the best way for them to reach an accord.

Indeed, while Asian governments, since last years of the past century, have endeavored to establish mechanisms for dialogue and consultation to maintain balance between the global powers, Latin American countries have ascribed little importance to joint actions to insure stability in regional and global issues.

Now, while the last three US administrations have held a committed policy towards politically isolating the People's Republic of China, abandoning the policy of containment, practiced since the establishment of US-China relations, the consequences of political friction between the US and China will be felt at all levels; regional and global, economic and political, and civil and military. These consequences, of course, will resonate even more deeply in the absence of consultation mechanisms, as is currently happening in Latin America.

The US political crisis (resulting from the reluctance of the Democratic Party to grant President Barack Obama fast-track authority to sign a still unfinished TPP) now leaves the Chilean, Mexican and Peruvian governments without any protection mechanism; viewed in a positive light, this situation is a great opportunity to contribute to the consolidation of the system of checks and balances built by ASEAN through the forums discussed throughout our work. However, the rules governing membership in the Pacific Alliance have attracted the interest of Europeans and Americans in the regional project. Throughout our text, we have provided sufficient information about the parallels between the political principles of the ASEAN and the PA, as well what it is that prevents the convergence of these parallels: namely, the potential risk of filtration into third party countries' matters, under the pretext of promoting human rights and the principles of representative democracy. This explains the wait-and-see attitude adopted by the governments of the ASEAN; as a result, members of the Pacific Alliance have an obligation, on one hand, to revise the norms governing membership in it; said revision would be a necessary condition, but not enough to bring about greater closeness between governments of the two shores; in this sense, the revision must have as a complement a convergence towards a foreign policy that is common to all four countries of the Pacific Alliance. Elsewhere, we have already pointed out some of the practical aspects indicating the benefits of having a common foreign policy;[16] now, all that would be left to do would be to converge systematically to overcome the existing differences between the four members of the PA. In concrete terms:

- The governments of Chile and Peru have implemented a strategy of openness towards the Asian countries, as shown by the trade agreements signed with them; the Colombian and Mexican governments, in contrast, have chosen to maintain a distance with their Asian counterparts, favoring relations with the governments of other regions.
- The governments of Chile and Peru, in the case of China, have chosen to acknowledge the market character of the Chinese economy; while the Colombian and Mexican governments have refused to do so, thus sustaining a point of tension with the Chinese authorities. The point is important, because the recovery of the Chinese President's initiative of the Free Trade Area of Pacific Asia, on the margins of APEC, may cause a crisis in the PA; to start negotiations, Chile and Peru will be

16. José Luis León Manríquez and Juan José Ramírez Bonilla, *op. cit.*

willing to participate in them, without waiting for their Colombian and Mexican counterparts.

Finally, we have seen that during the first two meetings between members of the PA and representatives of ASEAN, the outstanding feature has been the absence of a common-interest agenda. The construction of said agenda cannot be separated from the main point of concern to all parties: the stability in the regional and global spheres; Latin American countries in the PA have much to contribute to this, as a bridge between Europe, America and Pacific Asia; not doing this will mean losing the opportunity to consolidate the PA as a forum for dialogue and inter-regional political convergence, in order to suffer passively from the instabilities of the global system.

THE PACIFIC ALLIANCE: BUILDING DISCOURSES AND REALITIES…

Olga María Cerqueria Torres

1. Building the Present, Considering Past Experiences: Regional Integration in Latin America

Regional integration –in order to attain development- is not a recent initiative in Latin America. By the end of the 1950s, in the last century, ECLAC developed a structuralist economic thinking. The central axis was based on industrialization, accompanied by a series of preferences through the establishment of a free trade area and a customs union.

In addition, other elements of "protection" were developed –in some cases–such as Decision 24 on foreign capital in the Andean Pact. This Decision focused on the direct investment in those sectors (mainly manufacturing) that would be most affected: "…the objectives pursued through common treatment of foreign capital were the following: c) Avoid conditions under which foreign investment in countries could obstruct integration…" (Salazar, 1975, pgs. 10-11, cited in Tironi, 1977). Hence, the preferences and the protection towards the bloc, regarding the rest of the world, was a feature that defined the old Latin American regionalism. As a result, the Central American Common Market (CACM), the Latin American Free Trade Association (ALALC) and the Andean Pact, emerged.

A review of the rationality, fundamentals, and objectives of the Latin American integration occurred after a severe crisis in the 1980s. The role of ECLAC, IDB and World Bank was fundamental, especially between 1990 and 1994, to the extent that it provided a new framework for development policies. The governments also played a significant role.

This was a response to the changes generated in the Global Political Economy structures, where regionalism appeared as one of the most important

dynamics in the international system with regard to the neoliberal globalization expansion which resulted from the end of the Cold War.

Thus, in the 1990s, Latin American integration began a new phase. Authors like Bernal even talked about the development of a new paradigm, "open regionalism," also identified as "the new Latin American regionalism" (Bernal - Meza, 2005, pg. 159). This signified the adoption of a new economic development strategy: the outward integration strategy (Massad, 1989, pg. 213), which observes that the integrating commitments among a group of countries are compatible with the goal of creating a more open international economy. In fact, it gained acceptance, in both academic and government circuits, the idea that the aim of a more open international economy without impediments to the free exchange of goods and services and capital did not necessarily exclude the integrating commitments and that these could even facilitate their achievement (Rosenthal, 1993, pg. 13). Therefore, the liberalization and diversification relative to the world characterized this Latin American integration phase. These characteristics constitute what is known as multiple regionalism, or the *"spaghetti bowl"* as it is named by some authors, Bhagwati among them (1995).

As a result, the Central American, Caribbean and Andean integration processes –in crisis during the previous decade–were reactivated and the Southern Common Market (MERCOSUR) was launched.

This change turned into a series of institutional transformations, as well as of agenda and strategies. When defining the economic agenda, in regional blocs, some countries have chosen "hub and spoke" strategies, which are characterized by the proliferation of "South-North" bilateral free trade agreements and a greater focus on external markets, such as the Andean Community (previously the Andean Pact), the Central American Integration System (SICA), and the Puebla-Panama Plan (renamed Mesoamerican Project in 2008). In the region, only MERCOSUR seems to continue aiming at the goal of establishing a customs union, although it is still not quite perfect.

This open regionalism was projected in Latin America during the 1990-2005 period and meant the increase of agreements both with the European Union and the United States. Also, there was a more precise pinpointing of the relevance of emerging Asian countries to the region, given that for some Latin American nations, Asia has become the main export market, especially for raw materials.

The beginning of the year 2000 brought certain political changes in the Latin American region, such as the implementation of new left-wing

governments, which resulted in new regional leaderships, consolidating a project of ideological response to neoliberalism. This scenario has led to political and ideological disputes in the region with direct impact on the regional integration discourse in the CAN and MERCOSUR, specifically.

Furthermore, new projects emerged, such as UNASUR, the Venezuelan proposal of ALBA, and later CELAC, which gave higher priority to political, security and social agendas. With regard to the political agenda, there are two platforms: the South American platform through UNASUR, and the Latin American one through CELAC, which brings together Latin American and Caribbean nations. ALBA emerges against neoliberal globalization and uses the 21st century socialism as a framework reference that guides the process.

All these initiatives help to consolidate the supremacy of inter-governmentalism[1], since these integration processes emerge with a fully inter-governmental decision-making logic.

Some claimed that CELAC could become an alternative to the Organization of American States (OAS), since it emerged as a new political platform that included countries like Cuba and developed a dialog with other international players, such as the EU. To date, within the two platforms, Latin American countries maintain differences over their views on how they handle their strategies for economic integration with the main geo-economic centers like the United States, European Union, China and others. In general, they maintain different ideologies on how generate development for their countries. Nevertheless, the 7th Summit of the Americas –organized in April 2015 by the OAS–has been an important event to give a new push to the relation of Latin American countries with the United States of America, as this meeting was useful to make progress in the historical process of thawing the relationship between the United States and Cuba. The latter may become an essential part in relieving the tension in the relations between the United States of America and the Latin American countries bloc lead by Venezuela, although it was precisely the terms of the relationship with the latter that prevented the hemispheric meeting from ending up with a declaration.

With that being said, some Latin American representatives, such is the case of President Rafael Correa, from Ecuador, requested that CELAC become the Latin American representative in the OAS –"The Community of Latin American and Caribbean States (CELAC) should be the forum for Latin

1. It started some years before (early and mid- 1990s).

American and Caribbean debates, and the OAS should become the forum where, as blocs, CELAC and North America submit their coincidences and conflicts." According to Correa, "North and South America are different, and they should engage in dialogue as blocs."

One of the most recent integration initiatives in the Latin American region that is attracting international attention is the Pacific Alliance, launched on April 28th, 2011, when the Presidents of Mexico, Chile, Colombia, and Peru (summoned by the Peruvian Chancellor's Office) agreed on the Lima Declaration to "move gradually towards the free circulation of goods, services, capital, and people," thus giving a new push to the economic integration agenda in the Latin American region.

2. The Pacific Alliance: Towards the Construction of a Region?

Since its beginning, the Pacific Alliance has projected some peculiarities that distinguish it from the previous experiences of integration in Latin America regarding its objectives, institutional structure and management. In fact, all these elements will be precisely the subject of an analysis in light of the recent theory of international relations on regionalism, which is a necessary exercise of diagnosis and reflection in the process of emergence of a region.

2.1. *The Institutional Framework of the Pacific Alliance*

The Framework Agreement[2] defines several significant aspects, the institutional structure of the Pacific Alliance among these. This agreement has been subject to an internal ratification process by each of the member countries, Colombia being the last, whose Constitutional Court approved it and declared it enforceable on April 15th, 2015, allowing its entry into force in a short period of time.

A peculiar fact is that the Pacific Alliance institutions, namely the Council of Ministers, the High-level Group, and evidently, the Summits of Heads of State have operated even without the Framework Agreement being into force, advancing through countries' executive decisions, special agreements,

2. Signed at Paranal, Antofagasta, Republic of Chile on June 6, 2012 by the governments of the member countries.

bilateral agreements, necessitating a show of will from the member countries in order to speed up the process.

The Framework Agreement establishes the following regarding the Pacific Alliance institutional structure:

1) The Summits of Heads of State is the source from where presidential **Declarations** are issued. It is clear that even though these Summits are only mentioned in the Agreement, when other body attributions are described, they form a part of the Alliance's institutional system. In practice, the highest-level political decisions come from them; hence, the "Declarations" provide a political direction to integration. However, as this political direction is not explicitly acknowledged in the Agreement, Declarations do not represent legal rules per se, but rather give a practical political direction to the process.

2) The Pro Tempore Presidency, successively executed by each Party, is exerted in alphabetical order, in annual periods. Article 7 of the Framework Agreement defines the attributions of the Pro Tempore Presidency, in which it is established that the Presidency conducts duties corresponding to a Secretary. Thus, it is an executive body of the integration, in charge of providing technical support to other bodies. Thus, among its attributions the following can be mentioned –for instance–(a) organize and host the meeting of Presidents; (b) coordinate the meetings of the Council of Ministers and the High-Level Group (HLG) of the Pacific Alliance; (c) keep the record of minutes from the meetings and other documents; (d) submit for consideration the activity schedule of the Pacific Alliance to the Council of Ministers, with dates, locations, and the meeting agenda. The penultimate of the awarded attribution in the Framework Agreement is "representation;" hence, the Presidency is given the power to represent the Pacific Alliance in common interest issues and events on behalf of the Parts. Regarding this point, it is worth asking oneself if this means a legal personality attribution to the Presidency, by virtue of the role granted. Finally, the agreement establishes –in this article- that the Council of Ministers is the body that could grant other attributions to the Presidency.

3) The Council of Ministers, composed of the Ministers in charge of Foreign Affairs and the Ministers in charge of Foreign Trade, or those appointed by them, develops legislative and executive roles. This includes tasks from adopting decisions that build up the objectives and specific actions foreseen in the Framework Agreement, as well as in the presidential declarations of the Pacific Alliance, to establishing work groups deemed adequate for the completion of the objectives and the conduction of actions of the Pacific Alliance. One of the outstanding attributions is foreseen in Article 4, section f) where

it is established as an attribution of the Council "the definition of political guidelines of the Pacific Alliance in their relationship with third-party States or integration processes," later, because of the same nature of this Council's roles, it can also perform legislative and executive activities with regard to the implementation of this section. Of course, all these activities are developed in a context of political direction given by the Summits of Heads of State.

What's more, the Framework Agreement gives the Council of Ministers extensive powers; for instance, subsection i) states: "to adopt other actions and measures assuring the completion of the Alliance objectives."

4) The High-Level Group (HLG) of the Pacific Alliance was established in the Lima Declaration and the Framework Agreement. Although the latter makes reference to the HLG only to the time of establishing the powers of the Council of Ministers, the Framework Agreement does not assign any special article to developing its nature and roles. It is composed of the Vice-Ministers for Foreign Trade and Foreign Affairs, and it is in charge of monitoring and assessing the progress of technical groups, in order to devise new approaches and ways of projection with other regional organizations or groups, especially in the Asia Pacific region. In other words, to supervise and assess the work of technical groups, in order to subsequently submit proposals on the international projection of the Alliance. The work performed by this group is essential for activities that may later develop at the higher levels, such as the Pro Tempore Presidency, the Council of Ministers and the Summits of Heads of State.

A common characteristic can be identified when observing the institutions of the Pacific Alliance: each one is made up by the governments of member countries or by representatives thereof (at a ministry level, vice-ministry level and officers in general) where each member country speaks for itself; in other words, it is an intergovernmental institutional framework without supranational institutions in sight.

From the view of the international relations theory[3], it is worth asking if the inter-governmental institutions in the Pacific Alliance answer to the rationalist approach, in which an individual vision of international reality is adopted, and where the whole can be minimized to the interaction of parts and

3. In the field of International Relations more than one approach has been developed, each one with its corresponding suppositions on the regional integration; for instance, neo-functionalism and inter-governmentalism offer the classic debate. Nevertheless, Barnett claims that these debates are diversifying, and thus, the literature built up around the new regionalism reports a debate between rationalism and constructivism (Barnett, 1995, p. 490).

agents. It is focused, then, on showing the relevance of "parts/agents" whose interests, ideas and identities are considered as given.

These assumptions justify that the theoretical rationalist approaches such as the neo-realism and neoliberal institutionalism, are based on the "rational choice," where parts/agents are seen as egos protecting their own interests.

Consequently, member countries of the Pacific Alliance would only aim at maximizing their individual benefits, and there would have to be an understanding of the integration process as the sum of parts that does not address an "agent-structure" relation.

Assuming these assumptions as true, this would lead to a scenario in which the greatest aspiration of each member country is that their corresponding governments become negotiators of the State/Government/ internal stakeholders (economic, social) interests.

Ergo, the cost of admitting that this approach bases the integration of the Pacific Alliance in that no significance is given to the emergence of actors[4] (beyond States) with different regional views and ideas that would reformulate/compete with the political project proposed by the state representatives.

For instance, economic integration implies that the actions increasingly lead to higher levels of economic interdependence. For this to happen, not only is it necessary for governments to negotiate with each other, but the involvement of economic agents is also required. Thus, their association to the economic integration process impacts the agents' decisions and vice versa; the agents' decisions impact the economic integration process. For this purpose, the agents must set up their own version of a region: this means that the States are not the only significant actors in the process –there are also other actors.

Therefore, situations such as the one that occurred within the Andean Community of Nations are less viable, where the confrontation of governments of member states resulted in Venezuela's decision to step out. All this brought a series of consequences in all of the integration aspects.

As discussed up to this point, the inter-governmental institutionality would be an element that makes us question whether the rationalist perspective is the one basing integration on the Pacific Alliance. However, since the process started, we identify a condition common to all member countries: a condition precisely orienting the analysis towards the constructivist approach on regionalism that is centered on intersubjective practices among actors as

4. Economic, social.

a result of how interests, ideas and identities are formed in the interaction process amongst them.

Thus, the Pacific Alliance initiative to achieve the free circulation of goods, services, capital and people (intersubjective practice) was taken into account, considering that the region's countries share a vision of open economy to the world (identities), where integration emerges as a strategy to address the main challenges in the insertion process into the international economy, in a context of relevant global dynamism of Asia Pacific.

This common condition allows a structure to be projected based on a shared vision (identity), where other constructivist assumption becomes relevant, and focuses on showing the importance of the agent-structure relationship, since constructivism adopts a holistic view where the parts/agents exist only in relation to the whole. Ruggie (1998) claims that the international structures are primarily social structures that give shape to actors; thus, international structures provide a social identity to actors, and also condition their possibilities for action. Therefore, the social actors do not exist outside the social context, or outside meaning structures that are shared intersubjectively. However, constructivist theories emphasize an ontological position giving equal importance to actors and structures.[5] [6]

This idea reinforces the scenario in which confrontation and separation are less likely to occur between countries in the Pacific Alliance (as in the situation in the Andean Community), since the shared vision (identity) links them to an economic structural reality beyond the conjuncture.

Pragmatism is a manifestation of identity in the Pacific Alliance. It is present, for example, in the institutional proposal, as it does not have a complex framework, but a rather agile one, and the dynamic deployed so far has been to acquire concrete and compliant commitments in the short and medium term. This has been effective at the early stages of integration.

For constructivism, the starting point of regionalism lies in a cognitive construction (conscious process) of a regionalized world that is profiled (by designing an application of common, or coordinated policies) according to the logic, content or purposes that each region adopts according its own

5. Schunemann argues that it should be noted that mutual constitution of players and structures is difficult to operationalize in the research practice and the tendency to emphasize or structures or social action can serve as a criteria to classify the different constructivist aspects (2009). Structuralist theories and approaches privilege the social structures and explain, through them, players' identities and interests (Wendt, 1999, Fearon & Wendt, 2002).

6. (Adler, 1997; Wendt, 1999; Gamble & Payne, 1996; cited in Schunemann, 2009).

experience. Regionalism translates into ideas, identities and ideologies related to a regional project. As such, regionalism is clearly a political project, but obviously not one that is necessarily driven by the government, because the states are not the only political actors. Within each (formal or not) regional project, several competing actors coexist, with different regional visions and ideas. These actors provide the ideological content of the region.

As previously mentioned, in the case of the Pacific Alliance, some dynamics have been identified in this (institutional) integration dimension, which fit the assumptions of the constructivist approach to define this stage of the process. Thus, the vision (identity) shared by member countries (through their governments) would facilitate the economic regionalization process, a substantial condition to discuss economic integration. Although the States are not the only political players, several actors coexist, competing with different regional visions and ideas, which require their presence and clear formulation to build the integration process.

2.2. *Consolidation of the Economic Region*

From the economic point of view, regionalization is a process that can occur spontaneously (Spindler, 2002, pg. 6), or can it be induced. When successful, there is an increase of the regional economic interdependence in a specific geographic area. This can result in formation of new regions from which actors and organizations emerge.

In the Pacific Alliance, the goal is to improve regional economic interdependence in an inductive way.[7] This explains the initiative to achieve the free movement of goods, services, capital and people. The vision of an open economy to the world (under the principles of free market and economic openness) is established as a common condition among the member countries which allow the projection of a structural reality based on a shared identity.

Manifestations of a shared identity include, for instance, the economic policies that the member countries follow to reach development through

7. In addition to the aforementioned instruments, in order to regulate integration, we can also quote other important agreements, such as the Protocol Additional to the Framework Agreement of the Pacific Alliance, which is a commercial agreement, signed in Cartagena de Indias on February 10, 2014, and the agreement created by the Pacific Alliance Cooperation Fund, signed in Cali on May 22, 2013; both must come into effect.

economic, commercial, and financial liberalization. Blanco (2015, pg. 2) states that the Pacific Alliance member countries are at the forefront of Latin America in terms of economic openness, competitiveness and good investment environment: they are among the first five in the region in terms of economic freedom according to the Index of Economic Freedom 2014. They are also the four most competitive economies in Latin America, according to the World Economic Forum (WEF) and the four with the best business climate in the region, according to Doing Business 2014.

This purpose, to reach development through economic, commercial and financial liberalization, has meant a high commitment (previously contracted to the constitution of the Pacific Alliance), by member countries with the principles of free trade. These principles base their relationship on the integration process, and they also base their relationship of the Alliance to the world. Thus, the member countries maintain Free Trade Agreements (FTAs) previously signed with other countries and regions, as well as ongoing negotiations.

Another manifestation of this shared identity is to project a vision in common of a pragmatic and highly executive integration process. Moreover, Blanco (*ibidem*, 1) states that accomplishments achieved in just two years of existence denote great agility and flexibility in decision-making because in a relatively short period, they have committed to remove the remaining 8% in custom taxes among the member countries in the next seven years. What is more, visas have been removed to facilitate labor travel among member countries; common centers have been opened to promote economic and trade relations abroad; the Integrated Latin American Market (MILA) has been launched and integrates Chilean, Colombian, Peruvian and Mexican stock exchanges. This will be the first Latin American stock exchange for listed firms and capitalisation firms, surpassing the Brazilian Bovespa.

All these elements show that the Pacific Alliance was launched as a fundamentally economic initiative, which aims to promote the dynamics and contents for further integration among its member countries, emphasizing the importance of stronger ties with the Asian market. Therefore, we must not overlook the great challenges ahead in order to emerge as an effective and attractive region.

One of these challenges is having a weak commercial integration. Only a 5.3% average in export flow from member countries is sent to the other Pacific Alliance countries, and 7.8% of imports.[8] The same behavior takes place in the

8. Mexico and Chile are more integrated with MERCOSUR than with the Pacific Alliance, both in trading volume and in shares, in particular because of the economic relations of both countries with Brazil.

case of FDI, since the entire Pacific Alliance does not cover more than 10% of what was received by the Pacific Alliance member countries, in any case.[9]

Thus, the possibility of an enlarged market as a driving force to promote the interest of various economic actors is essentially important. For this reason, it is necessary to involve those economic agents from the beginning, since their level of involvement and commitment is what does or does not make possible the reality of an economic regionalization process.

Hence, targeting measures that lead to the generation of interest involves favoring (according to constructivism) communicative action–in this case–among the economic actors in the region. This communicative action refers to the interaction style in which the interests and identities of the actors cannot be assumed as fixed, but are subject to change. Given that, their ideas, identities, and interests are socially constructed and endogenous to the interaction process.

In this way, the communicative action creates and transforms the relationship among the actors, which is essential for economic integration to take place as an effective strategy to address the main challenges in the international economic insertion process in a global dynamics context that is relevant to Asia Pacific.

It is clear that the fluency level of this communicative action has to do with the logic, contents or purposes that each region adopts due to their own experience. This construction process is clearly a political project, but obviously not necessarily driven by the State, since they are not the only political players. Within each (formal or not) regional project, there are several actors competing with different regional visions and ideas. These actors provide the region's ideological content.

In the case of the Pacific Alliance, it is clear that the governments have –at this stage of integration–an important role when promoting the conditions to generate interest from economic agents, and to become agents that also provide an ideological content to the region, from their vision or visions of the region.

Additionally, it is vital to improve infrastructure and logistics in order to promote conditions in, as well a to, improve human resources quality and qualifications to generate business value. The most effective way to create clusters and agglomeration economies is by promoting greater cooperation among companies, universities and technology centers, targeting closer integration among the Pacific Alliance countries (Blanco, *Op. Cit*., pp. 16-17).

It is also important to recognize the need for the early implementation of a dispute resolution mechanism, precisely to rapidly execute integration measures.

9. (Blanco, *Op. Cit*. pg. 4).

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COLOMBIAN FOREIGN POLICY IN THE PACIFIC ALLIANCE: COOPERATION AND LEADERSHIP

Martha Ardila

Introduction

Latin American groups, such as the Pacific Alliance (PA), show changes in today's international and regional systems, which are linked to the crisis of old fashioned multilateralism and the emergence of regional powers of differening ranks in Latin America and Asia-Pacific. These countries have had different trends regarding integration.

This chapter seeks to link Colombia and the prototype country in of Pacific Alliance. If we can classify the country into one of the types of external relations, or on the contrary, combine different models of insertion, economic and political, ideological and pragmatic, and the presence of either head of state in his government house. At present, the country seeks to diversify its international relations and deepen its links with Latin America. Through the Pacific Alliance, it appears to have succeeded.

In light of this, this chapter intends to answer the following questions:

What kind of countries make up the Pacific Alliance? What is each one looking for in the PA? What changes have occurred in Colombian foreign policy, and what role do they play in the Pacific Alliance?

The hypothesis is that countries have different interests in the Pacific Alliance, making for a shared leadership that is rotationally exercised by the country's rightful Pro Tempore Secretary. In sight of the policy of economic diplomacy that has driven the Juan Manuel Santos administration, and the fact that this group was conceived as a deep integration agreement, Colombia generates profits for deepening ties and cooperation among member countries of the Alliance and Asia-Pacific.

In order to prove our hypothesis and answer these questions, we conducted interviews and reviewed secondary sources such as news and communiqués from the Colombian Ministry of Foreign Affairs.

This chapter is divided into three main parts. The first refers to changes in the international system oriented to the emergence of a New Multilateralism and Regional Powers, to characterize the countries of the Pacific Alliance in a new context of transition. In this part, we define some concepts relevant to our analysis as a region, as a leader and as a regional power, which provide elements for the precise pinpointing of Colombia in the regional hierarchy. The second part analyzes both the changes and continuities of Colombian foreign policy during the XXI century, showing their differences and similarities, and their search for a greater degree of autonomy and diversification. Finally, the third part analyzes Colombia in the Pacific Alliance, emphasizing its achievements and opportunities. Following from the general to the particular, it further examines the role the country played in the Presidency of the Pro Tempore Secretariat it held for one year, from mid-2013 to June 2014.

A New Regional Power

Several elements affect the genesis of new regional powers and the transition to a new regional power hierarchy, which give rise to new partnerships in countries such as the Pacific Alliance. The first refers to the decline of the United States in world affairs and the rise of other centers of power such as China, India and Japan. For example, between 2010 and 2020, the growth rate for China will be 8.7% of GDP; for India, 6.9%; for Indonesia 6.7%; 4.7% Taiwan; Korea, 4.4%; and Japan, 1.7% (Moneta, 2012)–while for the United States it will be around 3.5%; Canada, 2.4%; UK, 1.8 %; Germany, 1.6%; and France, 1.5% (World Economic Forum, 2014).

The rise of these poles of power in Latin America is accompanied by the emergence of regional powers of different ranks, such as Brazil, Mexico, Chile, Venezuela and Colombia, which occupy different positions in the hierarchy of regional and international power. Brazil, Chile, and Colombia increased in rank, while Mexico and Venezuela descended. Their quantitative and qualitative capabilities vary and change, often due to internal variables such as drug trafficking or the internal conflicts that cause instability, which are sometimes linked to external variables related to the capabilities and the perceptions that other countries have of them.

These features are presented in the context of emergence of new development models looking to become more autonomous and independent from the United States and seeking to diversify their international relations. It's called New Left, or *Ola Rosa*, in Latin America, which was led by Venezuela, headed by Hugo Chávez, but which has weakened during the administration of Nicolás Maduro, lowering oil prices in the international market, and deepening economic and political crises in the country.

When referring to Regional Powers and a hierarchy of power, we have to link two concepts: the region and the power, which have evolved, tending to a multidimensional component, forcing us to take theoretical elements of different epistemological currents.

Generally speaking, there are schools that emphasize external factors, such as the Realistic approach, which defines the region and power for their abilities among those that are not only military and natural resources, but also physical aspects, such as geographic location. In this respect, the territorial sovereignty (Krasner, 1999) and control are essential to its effective conceptualization. In this approach, the region is crucial in geopolitics; the territorial political component, and the specificity of the physical and strategic components.

There are other critical approaches which privilege goal-oriented internal variables and constructivism, and conceive the region as socially constructed by individuals and institutions with similarities and/or social, political, ideological, economic, ethnic and religious interactions. In them, the ideas and ideology are fundamental, and construct their identity based on often similar values and beliefs. Here, the region reflects a national interest, but for them the "seen" and perceived is part of its essence, alluding to the symbolic. And the Pacific Alliance is a region which, although Mexico is not a geographical neighbor, has in common an identity, ideas, cooperation and a high level of accountability.

In addition to the concept of region, the concept of Regional Power is important to understand not only the participation of Colombia in the Pacific Alliance, but also to examine its regional and international integration processes.

Traditionally, the concept of Regional Powers has been ambiguous and changing. The first who were interested in this topic were Canadians in the nineteen-eighties. Then, Carsten Holbraad defined them as those countries that due to their size, natural resources, political will, leadership and stability, could become a "power." They are further characterized by their economic

and military strength, and may mediate and moderate a point of accord between two countries and/or a North-South or East-West conflict.

The concept of power is a geopolitical reference that includes military, political and economic aspects, which refers to a set of countries and their ranking in the international system. Their differentiation is the ability to project military power in different regions of the world and the opportunity to exercise their political influence globally (Nolte, 2008). Moreover, the emergence of regional powers means emerging and/or altering the configuration of a new order and location in the United States, as well as in other centers of power in a transitional environment and increasing complexity.

For its part, the Regional Powers have "soft power," and are offered as mediators and partners from different countries and groups of nations. They tend to be respectful of the status quo; seeking to develop coalitions and political alliances; a claim recognition; are involved in the structure of regional governance; present political stability; and show a willingness to exercise leadership in foreign policy.

In this sense, the Regional Powers meet certain requirements related to their region; claim to lead; influence on geopolitics and identity; provide natural, organizational and ideological power projection for resources; economic, political and cultural connection to the region; impact on the regional governance structure; seek recognition by other States; and represent the interests of the region in various international groups (Nolte, 2006). They also lead projects of integration, coordination and cooperation in military, economic and political terms. Among them, security acquires special significance, either as a complex as community safety or security (Buzan and Waever, 2003). Also, economics and trade are important for the promotion of intra and extra-regional trade, as well as the collaboration that deepens ties between its members and cooperating with third parties. In all of them, the Pacific Alliance occupies an important place.

International interdependence analysts (Nye, 2008) begin to grant importance to the use of soft power in different types of governments. In general, so-called "great power" combines with the use of soft power. The last is a priority for regional powers. In this regard, Colombia's foreign policy is working.

They also are perceived and ranked by their legitimacy, representativeness and confidence. It is difficult to measure soft power, but overall, variables such as as ideological influence, society participation in decision-making, democracy and transparency are indicators of its extent, which ultimately

reflects the perception of a given country. That is why countries are concerned about civil society; to improve their image and make use of public diplomacy.

For high regional powers such as Colombia, soft power and public diplomacy are worth more in terms of improving a country's image, exercise its leadership, build new partnerships and find a new regional balance of power. But not only culture and politics, but also propagated values and foreign policy are elements which link soft power and public diplomacy (Nye, 2003) for regional powers of different ranks.

Regional Powers begin to have increasing impact in international forums such as the United Nations, UN, World Trade Organization, WTO and G8.[1] In Latin America, groups such as the Pacific Alliance, UNASUR (the Union of South American Nations) and CELAC (the Community of Latin American and Caribbean States) acquire a special significance.

Differentiation between Regional Powers and Secondary Powers is based on continuity and consolidation of a project according to its national interest, state policies, and international activities, capabilities (for example, military spending, natural resources, etc.); as well as its international image in connection to how it is perceived by other actors in terms of legitimacy, leadership and discourse.

Mexico and Chile are well placed in the regional hierarchy. The former stands out for its capabilities (population, land area, natural resources, GDP, economic growth, education indicators, and so on). Chile is a Secondary Regional Power (Ardila, 2012); its soft hegemony exerts a discrete leadership, not only because of its capabilities, but also because of the perception that other states have of this country in terms of its institutional resources, science and technology, and quality of democracy and diplomacy. Many wish to follow its economic ideas and acceptance of topics of diversity, and it is seen as a leader in material economic integration (Latino Barometer, 2010).

Furthermore, Colombia is a Secondary Regional Power that ranks lower than Chile. For several years, it remained isolated from the regional scenario, but since 2010, it has been changing its policies and international image. Colombia is part of CIVETS, with Indonesia, Vietnam, Egypt, Turkey and South Africa, and has had outstanding performances in multilateral organizations such as the United Nations Security Council, UNASUR, Project Mesoamerica and currently, in the Pacific Alliance.

1. Russia (temporarily excluded by the crisis in Crimea), Canada, USA, France, Italy, Germany, UK, Japan.

Colombian Foreign Policy: Change and Continuity

Since the 1920s, Colombia's foreign policy has been oriented towards the United States, moving towards an unconditional alliance with that country, which continues despite the current discourse of diversification–known as "*Respice Pollum.*"

There have been few moments of autonomy in Colombian foreign policy: only the governments of López Michelsen, with Foreign Minister Carlos Lleras Restrepo (1966-1970), during which the "*Respice Similia*" arose; during the first two years of the Belisario Betancur (1982-1986); and with the administration of Ernesto Samper (1994-1998). The latter were years of drug money scandals which delegitimized the Colombian government and distanced them from the Northern power. Since then, the *Plan Colombia* and *Plan Patriota*, led and negotiated by the government of Andrés Pastrana, with military cooperation on security, have been permanent.

Colombian Foreign Policy has a number of features, such as that of Presidential Diplomacy, an unconditional alliance with the United States, and a low level of professionalization in the Foreign Service. Among them, we also find a constant connection between the internal and the external, which linked to the internationalization of the Colombian conflict and external resources and cooperation to combat and/or reintegration of armed groups into civilian life.

We can identify other cyclical features of the language used by decision makers, such as diversification efforts, opening the political system to non-governmental actors, and insertion and approach to Latin America and other geographical areas such as Asia-Pacific. For example, Álvaro Uribe was characterized by his confrontational language and actions towards countries like Venezuela and Ecuador, mostly due to ideological differences, using the "Diplomacy Microphone"–various agencies and actors ruling on international issues. Among these was a lack of coordination and leadership, and everyone said precisely what they thought. During those years, foreign policy was instrumental to the Democratic Security Program, and was directed towards seeking military and economic cooperation and support to bring about actions against terrorism.

In mid-2010, with the change of government and the arrival of Juan Manuel Santos at the presidential palace, the style changed and became more oriented towards pragmatism. In November 2010, relations with Ecuador and Venezuela were normalized; today, Venezuela and Chile were present at the Dialogues in Havana.

Colombia proposes a Third Way, which President Santos had already referred to before becoming President of the Republic. In this sense, the head of State continues to promote a neoliberal model and open regionalism, but due to negotiations in Havana and the peace process, it is imperative that social policy and economic reforms be aimed at having a greater inclusion of the population, almost certainly through regional governance. Internationally, the Third Way must consider what the changes and continuities of foreign policy have been.

Colombia's relations with its neighbors have shifted from the ideological to the pragmatic. The issue of security remains a priority, not only by the presence of FARC members in Venezuela, but due to the various illegalities that occur at the border, which range from theft and the smuggling of petrol to traditional threats, such as the Colombian-Venezuelan dispute over the Gulf of Venezuela, or Conquivacoa.

In this context, Colombia is approaching other countries, like Brazil and Chile. With the first, a border of 1,644 kilometers is shared, creating the COMBIFRON (Binational Border Commission, August 2011), and an Agreement of Economic Complementation (CAN-MARCOSUR, 2004) was signed. Colombia has also deepened relations with Mexico and Peru; the latter is also a neighbor, with a shared border of 1,626 kilometers.

Colombia in the Pacific Alliance

Colombia, Chile, Mexico and Peru are all members of the Pacific Alliance, created on April 28, 2011L; this alliance was formalized on June 6, 2012, with the signing of the Framework Agreement in Paranal, Chile. These four countries are based on a model of openness and the development of policies of so-called "Open Regionalism." Mexico seeks to counterbalance the structural relationship with the United States, while Colombia is interested in both Asia-Pacific and the Latin American Pacific countries.

Chile had an early entry into the Asia-Pacific region, unlike Colombia, which gained a rather late entry (Ardila 2012). It is part of APEC, and has an institutional framework with several Asian countries. In turn, it has internally developed the Pacific region, road infrastructure and gatehouse. Mexico and Peru have also been projected into the Pacific and integrated the APEC economic forum, which Colombia has not formally entered, but integrates into its workgroups. Mexico seeks to balance its relationship with the United States, having had an interest in this region for many years, like Peru.

Chile has signed FTAs and EPAs with 51 countries; Colombia, 15 FTAs involving nearly fifty countries; and Mexico, 10 FTAs with 45 countries. With this feature, they seek to promote intraregional trade. For the country, economic diplomacy is one of the pillars of international insertion, which has the support of the population. Unlike the other three countries, there is debate about the type of model and type of insertion that suits its best interests; said debate may have hindered its applicability.

For many years, Colombia neglected its economic and institutional diplomacy, and closed embassies in Asia-Pacific, in contrast to other Latin American countries. Brazil has 16 embassies; Chile, 12; Mexico, 11; Peru, and Colombia, 10–three of which were opened or reopened during Santos's present administration. This government initiated a process of reopening some, such as those in Indonesia, Singapore and Thailand. In turn, sales offices were shared with Chile in cities such as Shanghai. However, the effort made so far is insufficient and sometimes gives the impression that its interest in this geographic area is more rhetorical than real. Colombia lacks a continuous and effective economic and institutional presence in that region.

However, advances were made in negotiating FTAs with the region, as was done with South Korea in 2013. This is expected to bring benefits to the agricultural and agribusiness sector. The agreement will also allow for an increase of Korean investment flows, and thus strengthen, modernize and diversify the domestic industry. Colombia also works on improving productivity and competitiveness to enable access to sectors with potential in the Korean market such as auto parts, textile design, software, process outsourcing, cosmetics and health tourism. However, this agreement has not been ratified by the Colombian Congress.

In turn, Colombia and Japan signed the Bilateral Agreement of Foreign Investment Protection. (BIT). There is particular interest in outsourcing services, software and services for information technology, steel, automotive, renewable energy, mining and infrastructure, among others. Also, in May 2015, Chinese Premier Li Keqiang visited Colombia and subscribed to an Agreement on Economic and Technical Cooperation between the two countries.

To members of the Pacific Alliance, Colombia has been strengthening economic and political ties, with some objections from the commercial field.

Interdependence in the Pacific Alliance

Although interdependence has grown, economic and trade trends are somewhat similar for all these countries. For Colombia, the trade balance with Mexico has been unfavorable, and is tending to its detriment, as we have said, mainly through agricultural economic associations. Nearly 20% of trade is concentrated in car sales, and imports are mainly petroleum. The trade balance is US $7.065 billion, and the deficit for Colombia is US $5.4 billion. Mexican trade is mainly leaning on the United States (more than 80%); and only 1.1% is with Colombia (*Portafolio,* February 2014).

In this context, Pacific Alliance signed an Additional Protocol to the Framework Agreement which seeks to establish a free trade area among member countries of the Alliance. Through it, 92% of industrial tariffs are reduced to zero, while the remaining 8% will be gradually dismantled within a maximum 17 years, in an attempt to protect sensitive goods in the agricultural sector.

The Colombian agricultural sector felt concerned, and opposed the signing of this trade agreement, particularly from the perspective of the Agricultural Society of Colombia, or SAC. The criticisms focused on tariffs for fruits and vegetables which were removed, or reduced between 50% and 80%, for milk, beans, pork and cocoa, and which will be completely eliminated for short periods. Farmers disagree with the signing of this treaty, which has so far been the only treaty that does not have a "safety net to offset losses to national agriculture." Additionally, no safeguards are in place, which caused the withdrawal of the SAC during negotiations of the signing of this agreement.

The SAC, in "support of the sensitivities of 213 Agricultural Trade Products in the PA Frame," argued its reasons for rejecting this trade agreement. A particular case is rice; during the 1990s, millions of hectares of crops were lost as a result of unilateral tariff concessions made by the country. Today, rice provides about 65,000 direct jobs and accounts for the main economic activity in some regions, such as El Espinal, Tolima.

In an interview with Rafael Hernández, the Fedearroz Manager said that this agreement does not help the rice sector at all, because among other things, Peru is a net exporter of this product with which Colombia must compete. On Mexico's side, its free trade agreement with the United States is affecting rice production; the original 300,000 hectares being used for rice crops dropped to 30,000; today, this number is recovering, and hovers around 100,000 hectares. However, rice that comes to Mexico from the United States can also reach

Colombia under the Pacific Alliance agreement. What is clear is that there are Colombian productive sectors, represented by unions such as the SAC and Fedearroz, which are being affected by the implications of the Pacific Alliance, and who feel that their interests are not being properly represented *(Portafolio*, February 2014).

In contrast, Chile and Peru have trade surpluses in relation to Colombia. Relations with Chile date back to the time of "Great" Colombia, when Bolívar Joaquín Mosquera was appointed plenipotentiary ruler to the governments of Buenos Aires, Chile and Peru, which were institutionalized 100 years later in 1922. Currently, these relationships are going through a time of dynamism and extensive political dialogue. The two countries have been increasing their convergence in various areas of common interest, such as economic diplomacy, energy issues, academic cooperation, migration and trade with Asia-Pacific.

On 1991, an agreement on technical and scientific cooperation that contributed to the deepening of Colombian-Chilean relations was signed. Two years after that, the Bilateral Commission was created. Ten years later, in 2011, Colombia and Chile signed a Memorandum of Understanding for a strategic partnership in trade, culture, cooperation and socio-political issues. In addition, the Mutual Recognition Agreement was signed, as well as a Memorandum of Understanding aimed at the prevention and control of people trafficking and the smuggling of migrants.

Bilateral trade has been growing, there is currently a trade balance of US $1.2 billion in Colombia's favor, mainly due to the export of petroleum and the import of apples, grapes and pears. Bilaterañ trade in 2013 between Colombia and Chile accounted for 3.63% and 1.62% respectively in exports and imports between Colombia and the world. Economic and trade relations between the two countries are governed by the Free Trade Agreement signed on November 27, 2006, and are in effect since May 8, 2009. This Agreement constitutes the Additional Protocol to the Economic Complementation Agreement. Colombia and Chile also signed an Agreement for the Promotion and Reciprocal Protection of Investments on January 20, 2000.

The ACL-FTA has expanded and boosted bilateral relations and has provided extensive experience as a trading partner as well as in terms of exertion of regional strength. Likewise, Colombia has become the leading destination for Chilean investment abroad, with over $5.3 billion dollars in 2013, completing a 62% of total investment abroad from that country (*Portafolio,* June 2014).

The work of the Alliance is advanced through the Technical Groups, which are identified as specific needs and are coordinated by a member that is periodically rotated. Currently, it is followed by 18 groups, two of which (the Cooperation and Movement of Persons and Transit Facilitation Migration) are coordinated by Colombia:

1. Trade and integration
2. Cooperation
3. Public procurement
4. Services and capital
5. Intellectual property
6. Movement of persons and transit facilitation of migration
7. Communication strategy
8. Institutional affairs
9. Regulatory improvement
10. SMES
11. Committee of experts to analyze the proposals of the CEAP
12. International fiscal transparency
13. ERG relationship
14. Innovation
15. Promotion agencies
16. Tourism
17. Education
18. Mining and energy development

Colombia's Leadership in the Pro-Tempore Secretariat

The Framework Agreement of the Pacific Alliance established the figure of the Pro Tempore President, which is exercised for one-year periods by member countries, and should coordinate and lead actions and guide and represent the group on issues of common interest.

Colombia received the Pro Tempore Presidency of the Pacific Alliance on May 23, 2013, at the Seventh Presidential Summit held in Cali, Colombia. At that time, the countries had advanced in the negotiation of the Trade Protocol, due to the fact that the Colombian presidency was generally directed to this end.

This protocol contains 19 chapters to supplement and update joint bilateral agreements, is oriented towards free trade, and eliminates charges on 92% of all tariffs, while the remaining 8% include periods of gradual reduction.

In it, trading operations are also simplified, unjustified non-tariff barriers are shrunk, standards for the protection of human and animal health are established, access to government procurement markets is regulated and stability and legal certainty is provided to entrepreneurs and investors.

To complement this, trade facilitation to achieve interoperation of Single Windows International Trade was launched, in order to enable the sending and reception of electronic certificates. The first step in this direction has been the establishment of a rapprochement and cooperation between customs authorities and foreign trade.

Moreover, the Pro Tempore Secretariat, led the consolidation of a student mobility platform, reporting four successful calls and 444 scholarships for students, researchers, and teachers from the countries making up the Pacific Alliance. In turn, a Memorandum of Understanding on work and vacation time was signed, which will enable young students from Chile, Colombia, Mexico and Peru to enter any of these countries as tourists and perform remunerated activities during vacation periods.

In order to facilitate the mobility of citizens of the Pacific Alliance, tourist visas and visas for entrepreneurs developing unpaid business activities were eliminated by Mexico and Peru. Complementarily, the Traveler's Guide of the Pacific Alliance, aimed at travelers from the four countries, contains interesting information and useful recommendations such as migration information, consular information and the location of embassies, among others things. This release has served to further deepen the exchange platform of migration information, which allows for the flow of data in real time between immigration authorities.

Similarly, consular assistance has been encouraged in places where there is no diplomatic or consular representation from their country of origin. This initiative, given momentum by Colombia as Pro Tempore President, gave the initiative to share diplomatic missions, embassies and commercial offices. Today, PA countries share seven embassies around the world.

At the same time, tourism was identified as one of great potential markets and centers for cooperation. For promotion, a booklet was prepared with the main tourist destinations in the Pacific Alliance; a multiplay trip was designed; tour operator meetings in member countries were conducted; and IMEX was participated in jointly (IMEX is Meetings, Incentives, Conferences and Exhibitions, one of the most important tourism fairs in the world). The elimination of visas contributed to an increase in intra-Alliance tourism.

Moreover, the President acknowledged that SMEs are the prevalent business model in the Pacific Alliance, and therefore, a Technical Group to share best practices for its promotion was created. Also, regulatory standards to promote trade and economic growth and progress have been improved, as well as the refinement of protocols for the exchange of tax information at the highest international levels, in order to promote the transparency of the operations performed in economic transactions across international borders over time.

Aware of the great potential of the Pacific Alliance in areas of agricultural trade, work aimed at promoting exports in these sectors between our countries and third parties was brought forward. Complementary to these actions, a mechanism for the exchange of information on agricultural inputs, which will have better elements for decision making to facilitate access of farmers, was developed.

Finally, it is worth noting the Integrated Latin American Market, or MILA (*Mercado Integrado Latinoamericano*), composed initially by the stock exchange markets of Peru, Chile and Colombia, which began operations in May 2011 with the aim of integrating capital markets in the three countries, thus giving investors from these countries a greater supply of securities and issuers from a unified stock exchange. This represents a great integration effort for the Pacific Alliance in search of greater economic competitiveness, not only in the region, but in the world. In August 2014, the Mexican Stock Exchange was incorporated as well. With the entry of the Aztec country, MILA is located almost at the level of Brazil in market capitalization (number of issuing shares), setting it as the second largest stock market in the region.

The entry of Mexico into MILA is a good opportunity, but one must keep in mind that there are many differences with MILA at the policy and exchange level, so that a transition period is needed in order to better understand its behavior. During the month of July 2014, the volumes traded in this market reached US $4.977 billion, representing an increase of 18.94% from the previous month, when it was US $4.185 billion. By percentage share during the month, the BVC (Colombia) represented 48.77%, with US $2.427 billion, followed by the BCS (Chile), with 45.37%, $2.258 billion; third was the BVL (Peru), 5.87%, with US $292 million.

The market in Mexico is about the same size as the entire rest of the MILA combined. Having access to such a large market, which is growing to almost double its original size, will be very good for Colombia. Besides, the three countries will benefit from the entry of U.S. money through the Mexico.

In this sense, one can conclude that the Pacific Alliance has positioned itself as one of the best performing groups in terms of GDP, surpassed only by the BRICS and the ASEAN. This demonstrates the seriousness pointed to the organization and the will of its Member States to make this challenge a successful long-term reality.

Conclusion

In recent years, Colombia has shown a greater interest in approaching Latin America and Asia. The Pacific Alliance is a group association that serves as a framework for deepening these links. It has been important all its members, which have enjoyed a growing interdependence across various sectors.

Previously, Colombia had failed in its effort to gain economic entry in the Pacific Region, which was most poignantly manifested by its impossibility of belonging in the APEC as a full-fledged member and thus strengthening an institutional framework. Although it is still in the process of gaining entry into this economic forum, it has sought other forms of integration in the region, such as opening and individual and shared Embassies and Commercial Offices and uniting with other Latin American Pacific countries in developing joint political and economic actions; the Pacific Alliance is precisely one of these actions.

In this effort, Colombia combines action and new alliances with the bilateral efforts of apolicy of Cooperative Multilateralism. Although Colombia, and other members of the Alliance, are supporters of Open Regionalism, in which the Economic and Presidential Diplomacy play an important role, the actions and achievements of the country are not limited to economic areas, such as the Trade Protocol that the country managed to bring to fruition during its Pro Tempore Presidency, but cooperation is and has been the backbone of their participation in this group association. Cooperation in academics, consular, institutional, and several other fronts have helped to potentiate Colombia and its other members in a very attractive multilaleral body with large projections, so that other countries now have their eyes on the Alliance–including Brazil, Venezuela and the United States–as well as countries from other regions, such as the European Union. Colombia's participation in this Alliance has meant more cooperation than integration; in its short life, it has strengthened links with other Member States and Asia-Pacific.

At a level of the hierarchy of regional power, Colombia ranks as a Secondary Regional Power, showing a strong political will for rapprochement and reconciliation between countries with different projects and political and development models. This cooperative effort, conciliation and dialogue is a part of the emerging soft power and public diplomacy that shows the strengths of the country. However, the internal situation related to the inner conflict and low levels of development of the Colombian Pacific could hinder this effort. Within this, the positive role of business has been, and should remain, an engine for development and participation in the context of a collaborative diplomacy.

While Colombia demonstrated its leadership with the Presidency of the Pro-Tempore Secretariat, this has been shared with other members of the Pacific Alliance. For this reason, and because of the structure of this group and the new multilateralism that develops in the region, Colombia's leadership in the Pacific Alliance was a shared leadership.

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THE PACIFIC ALLIANCE A POTENTIAL CATALYST FOR STRENGTHENING THE CELAC AND PAVING THE WAY TOWARDS A GENUINE STRATEGIC ALLIANCE WITH THE EU

Christian Ghymers

The emerging new integration scheme between the four main economies of the Pacific coast – coined the "*Pacific Pumas*[1]"–with the "Pacific Alliance" (PA) launched in 2012, has impressed by its fast realization, attracting the majority of the FDI inflows going to the CELAC, exporting 30% more than MERCOSUR, posting the best performance in the region (5% annual growth rate since 2005) and reaching together a higher economic weight than Brazil. The Pumas have indeed taken the top places among Latin American nations in most of the international rankings.

In this chapter, the case of this PA success is analyzed as an implicit benchmark for assessing the evolution and challenges the whole CELAC is facing for integrating its components both between them and in the world economy. The PA is considered here as an interesting result of the combination of the globalization forces with the merits of political maturity and good governance which ensure the respect of the "rules of law" with business-friendly dispositions. However, the PA could be seen also as an automatic consequence of the success of similar economic models based upon sound macroeconomic policies and global integration: as soon as stability and openness are credible, regional integration is merely an automatic result, not necessarily a cause of success. Probably the PA has already eaten the easiest part of the road towards a genuine integration, because these four pumas have very few intra-regional

1. George, Samuel. "The Pacific Pumas: An Emerging Model for Emerging Markets". Bertelsmann Foundation, 2014.

trade exchanges (less than 4% of their trade). So the next step is the real challenge of regional integration, not only among these four economies but with the whole CELAC area. For continuing their successful convergence towards the "first world," they need a more genuine regional integration. This imposes a combined double efforts: (i) to deal quickly with deeper aspects of their integration in spite of their competition for attracting FDI and moving up into Global Value Chains, and (ii) to rapidly broaden their regional economic basis, which is already more integrated with their neighbors belonging to the less open MERCOSUR scheme. These two efforts have the advantages of being linked by an intrinsic dynamics, the deepening-widening dynamics[2] observed in other regional integration, especially the European case.

As explained, this chapter adopts a broader regional view in order to make possible a better identification and analysis of the PA. This is why it starts from a diagnostic of the fundamentals of the CELAC region.

Since the 2000s, Latin America become used to familiarizing observers with good news. After the euphoric period of high growth during most of these years, the region has impressed by its capacity for weathering the storm of the global financial crisis, even creating the impression of a decoupling from the industrialized countries cycle. Indeed, the growth performance almost doubled its long run average (excepting the year 2009), reversing the 50 years of relative decline of the region *vis-à-vis* the U.S: from a level of 50% of the income per capita of the US in the 1950s passing through a low of 23% in 2004, this indicator is now hovering around 30%. Not only growth was impressive but also socio-political progress, with significant reduction in poverty rates (73 million left poverty ranks)–even in the average degree of income inequality measured by a GINI coefficient (decreasing from 54 to 50)– the emergence of 50 million of new "middle-class" persons, the inclusion in the labor market of more than 70 million women, a clear consolidation in democratic and sound macroeconomic governance, with few exceptions, as deficit, debt, inflation, current account and banking clearly under control in most Latin American countries, which have "graduated" in terms of their policy responses being able to switch to some degree from pro-cyclical to counter-cyclical policy responses. On top of this concert of good news came the launch of the pragmatic integration scheme of the PA, which opts visibly for global openness and introduces an internal dynamic in the region.

2. Baldwyn, Richard, Baldwin, "A Domino Theory of Regionalism." NBER Working Paper No. 4465, 1993.

Wouldn't all these converging positive trends be enough argument for considering that CELAC area will be part of the world growth locomotive for the coming decade? Therefore, shouldn't other regions like the EU gear its policies towards a higher speed and deeper degree of relations with this emerging region?

The answer proposed in this chapter to the first question is that most arguments go towards a NO: the economic growth in the CELAC area is not yet sustainable, even in the most stable and successful ones if the regional integration would make no fast progress together with a better integration into external markets. Even the successful Pacific Alliance (PA) reflects more structural changes in the world economy than genuine endogenous forces. However, contrary to superficial views, this answer NO leads to answer clearly YES to the second question: EU and CELAC weaknesses are additional reasons for spurring a deeper Strategic Alliance between the two regions for stimulating their own domestic and external policy reforms. In this strategy, the PA could become a crucial player, as it also needs a deeper integration with the economies of the alternative scheme of MERCOSUR which are blocked by their insufficient external openness and market reforms. Latin American success is greatly artificial, except in the four economies composing the recent Pacific Alliance (PA) as is shown in Section 1, but this PA success remains insufficient as long as their integration inside the CELAC area does not progress more. Adopting a perspective in terms of Global Value Chains (GVCs) in Section 2 allows for identifying the inadequacy of the CELAC insertion in the global economy as the main cause of the poor performance of growth. The Pacific Alliance, although clearly on a better foot, does not rely upon deeper regional integration. Section 3 argues that the combined weaknesses and challenges the EU and the CELAC economies are facing open special opportunities for focusing the CELAC-EU Summit diplomacy upon the definition of cooperative actions for achieving greater competitive presence in value chain segments with higher value added, as well as strengthening their respective position with respect to the Mega-regional negotiations. In Section 4, this chapter considers that the Chilean slogan proposed to the PA –"convergence in diversity"–opens the path for a solution, making of the PA the catalyst of pragmatic reforms for generating a new dynamics in the regional integration and Summit Diplomacy.

Section 1: Is the Recent Impressive Socio-economic Progress of CELAC Countries Sustainable?

Unfortunately, no. The successes registered from 2003 to 2012 are already over, having been mostly dependent upon exogenous conditions or non-reproducible factors which were not properly used for reforming sufficiently their economies and governance. This tough affirmation does not deny the genuine efforts made in governance improvements in several countries (not all!) and the possibility to deepen and broaden them while facing adverse conditions in the future, but political economic realities demonstrate that good conditions are usually wasted, and rather tend to create potential new difficulties. Policymakers cannot be complacent, since they were not able to exploit them for increasing potential output and productivity, and are now exposed to an illusory success and new, hidden fragilities which will further complicate their tasks.

Recent macroeconomic development and a new and less favorable global context point to a return to mediocre growth rates in the CELAC region, and all forecasters were excessively optimistic up to summer of 2014. This is all clear when seeing the general downward revisions in macroeconomic forecasts during 2014, even for the "good bachelors" of the classroom. Although most of Latin America's slowdown is clearly cyclical after the exceptional boom in commodity prices, the continuous downward revisions in medium-term prospects are an indication that potential output growth was overestimated by a euphoric overshooting. This rate appears now under a sharp revision from 4 to 5% towards 2 to 3%, which inevitably would condemn the successes to be turned in tragic failure, since the "social fabric" could not resist such a disillusion in the existing unfair situation of worst income inequalities in the world. Most –if not all–of the social progress was the result of the additional growth. If this growth is not warranted by structural reforms allowing for a higher sustainable growth path, but on the contrary, are explained by non-reproducible factors, the governance difficulties will be even worse for facing popular frustrated expectations while macroeconomic and financial constraints will quickly and cumulatively deteriorate. Another way to formulate the present crossroad is whether it was the higher growth (and the terms of trade windfall bonus) which made possible social and democratic progress, or alternatively whether the reforms made possible higher growth and structural changes. Unfortunately, again, most of the indicators flash towards the first option: the social reforms and progress followed the economic bonus and not the reverse.

This is why the future is even darker for some countries: when windfall gains are consumed or misused in "populist clientelism," the social frustrations will increase all the more, as the cake shrinks.

Let us examine more precisely the risks of economic fragility for the CELAC area; first, observing average indicators for the region as a whole, and second, by identifying three different categories of countries and policies.

The first worrying indicator for the future –and the most synthetic one– is the *stagnation of total factor productivity in the CELAC area* taken as a whole. Economic output and hence, income earned depends on both the amount of the factors employed (capital and labor) and the productivity of those inputs, known as total factor productivity (TFP). Growth in income is normally considered sustainable if backed by growth in underlying TFP. According to IDB reports[3] the typical country in the CELAC region has actually had faster factor accumulation relative to the advanced economies (both the physical and human capital gaps were reduced) but the relative productivity of those factors declined from 78% to 53%, again relative to advanced economies. Since 1960, income per capita of the typical country in the region declined by 16% relative to the rest of the world and relative productivity declined by 18%. Relative to the typical East Asian, total factor productivity in CELAC economies was halved and the situation has not improved in spite of the decade of high growth. Therefore, the gains observed in income per capita are mostly due to temporary factors (terms of trade, labor supply, cheap capital inflows, activation of unused capacities, consumption of environment capital and not renewable resources) unable to found competitive economies. For the future, the underlying lower growth in productivity will limit potential output to a lower rate of growth which would be unable to sustain simultaneously a reabsorption of the social debt, the education and R&D investment required for improving relative position in the global specialization ladder, and the higher saving/investment ratio for implementing the infrastructures and logistics for materializing better participation in the global value chains without incurring external imbalances.

According to alternative calculations[4]-made from the KLEMS/Conference Board database–total Latin American productivity was still lower in

3. See IDB, Andrew Powell, coordinator, *Global recovery and monetary normalization: escaping a chronicle foretold?,* March 2014, Washington DC, and

4. Ariel Coremberg, "La Productividad de América Latina ante el auge de precios de productos básico,s" Cuadernos Económicos de ICE, 84, p. 123-153, ARKLEMS+LAND.

2011 than at its 1990 level! Total Factor Productivity has not increased in more than 20 years of growth. Such a negative outcome in the key-measure of the long-run determinant of economic development indicates a worrying lack of efficiency in the economies of the whole region. In spite of possible debates about the difficulties of precise measurement of the TFP for individual economies, the criticisms are not so valid for the whole area thanks to the probability "*law of the great numbers,*" which allows for making up for the measurement errors. Also, other research at the OECD[5] points to the same efficiency issue: on average, low productivity is the main factor that is holding back Latin American economies; that is, the efficiency with which factors of production are combined constrains growth more than the availability of plants, equipment and well-educated workers. In other words, a "factor-accumulation" strategy, although necessary, is not sufficient, since it would leave untouched the greater part of the productivity problem in the majority of Latin American countries.

In order to base our diagnostic upon broader indicators, the best method is to follow the Brookings method for analyzing the "economics of convergence" which allow for answering whether Latin America's income convergence was associated with a comparable convergence in growth determinants. The Brookings Institution[6] concludes: "[The last decade's] *high growth and income convergence were largely the result of an unusually favorable external environment, rather than the result of convergence to advanced-country levels in the key drivers of growth. Fundamentally, the last was a decade of "development-less growth" in Latin America. With the extremely favorable external conditions already behind us, the region is expected to grow at mediocre rates of around 2 percent in per capita terms for the foreseeable future. With this level of growth, the dream of convergence and development is unlikely to be realized any time soon*."

On chart 1, according to the Brookings key drivers of growth (trade integration, physical and technological infrastructure, human capital, innovation, and the quality of public services), during the last decade, LAC-7 countries[7] failed to converge towards advanced country levels in every growth driver. The overall index of growth drivers–the simple average of the five sub-in-

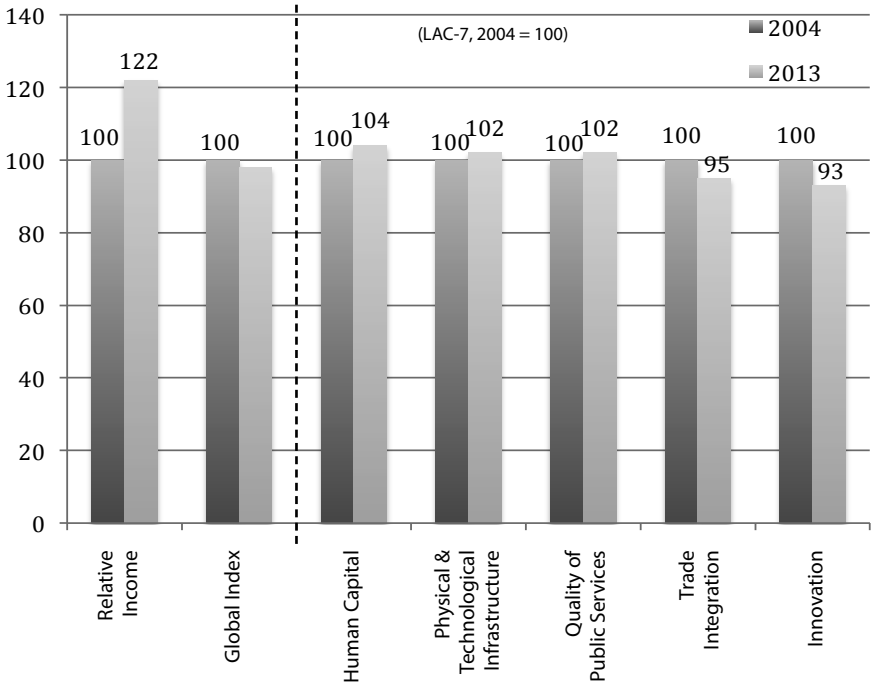
5. Christian Daude.

6. Ernesto Talvi, *Latin America's Decade of Development-less Growth*, Think-tank 20, Brookings Institution & CERES (Centro de Estudios de la Realidad Económica y Social, Montevideo).

7. LAC-7 is the simple average of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela, which account for 93 percent of Latin America's GDP.

dexes–remained unchanged in the last decade relative to the equivalent index for advanced economies. By and large, the latter holds true for every LAC-7 country with exceptions like Colombia (the only country that improved in every single growth driver in the last decade) and Chile (the country in the region where the levels of growth drivers are closer to those of advanced economies).

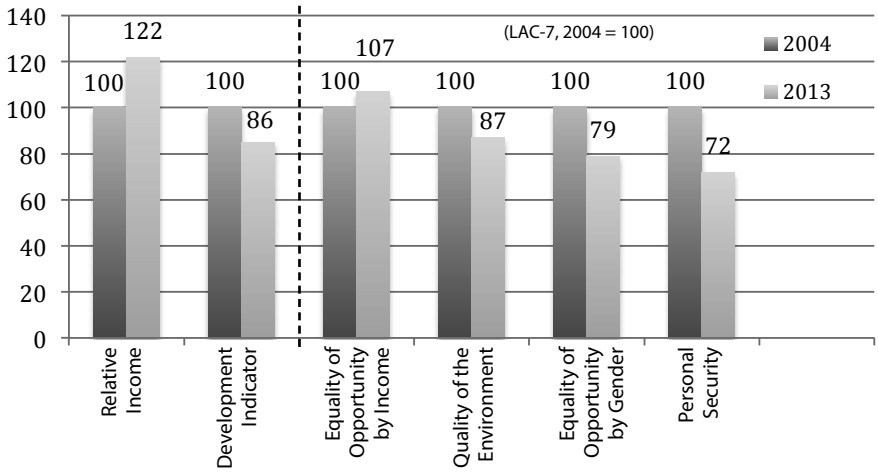
CHART 1: Convergence of income compared to Brookings convergence of growth drivers *(Source: Ernesto Talvi, Brookings 2014)*



Source: The Conference Board Total Economy Database™, World Economic Forum, Barro-Lee Dataset, The World Bank Development Indicators, NetIndex | Speedtest, OECD-WTO and World Intellectual Property Organization.

Moreover, the drivers of growth failed to converge in Latin America in the last decade, nor was income convergence accompanied by any comparable convergence in key indicators of development, such as equality of opportunity by income level and gender, the quality of the environment and personal security. On the contrary, these indicators are all but "equality of opportunity" driven towards further under-development (see Figure 2).

CHART 2: income convergence of income compared to Brookings convergence of development drivers *(Source: Ernesto Talvi, Brookings 2014)*



Note: LAC-7 is the simple average of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela, which account for 93 percent of Latin America's GDP. For details of the calculation of the indexes see Appendix.
Source: The Conference Board Total Economy Database™, World Economic Forum, Barro-Lee Dataset, The World Bank Development Indicators, NetIndex | Speedtest, OECD-WTO and World Intellectual Property Organization.

Therefore, we must conclude that for the CELAC area as a whole, the recent bout of convergence that started in 2004, after a quarter of a century of relative income decline, is not a break with the past but just a short-lived phenomenon which is vanishing with the less complacent global context marked by the imminent end to China's investment-led, credit-propelled growth model, the slow growth in advanced economies, the resulting softening commodity prices and the gradual increase in the cost of international financing for emerging markets. This first conclusion does not exclude that some economies –and more precisely, the four of the Pacific Alliance–could reach a genuine convergence, but anyway, there will be no automatic convergence if the present situation and policies do not change. Specific policies are required for consolidating the positive advances, essentially by implementing a specific strategy to address low productivity issues and by accelerating regional and external integration as we propose in section 2.

Taken as a whole, the CELAC region is exposed to rising risks of fragilities able to reverse the recent progress:

– The terms of trade have begun their adjustment after an exceptional improvement for most of the economies; since these relative prices

development generated temporary but enormous inflows of additional income, both in external and in fiscal accounts, debt ratios were easily cut; this is now over and the expected negative development of terms of trade will reduce incomes directly and indirectly with multiplied effects (on expenditures and receipts);

- The re-primarization of the economies as they enjoyed a commodity boom which created over-valuated exchange rates, biasing the internal terms of trade between primary exports and non-traditional output, attracting resources in the primary sector at the expense of industrial activities and exports (share of exports of manufactured goods fell from 51% in 2000 to 42% in 2013); furthermore, the export structure tends towards a re-concentration and a high dependency of China in a typical center-periphery dependency. The commodity boom created an investment boom in some economies which cannot be prolonged, making room for a cyclical recession;
- Aggregate regional exports in value have stagnated for more than three years since mid-2011 to 2014) and the fall in commodity export prices has not reverted the general tendency towards concentration in products based on natural resources, to the detriment of manufactures;
- The demographic dividend of higher activity rate by change in the demographic pyramid and increase in women's participation are reaching an end; they won't contribute any more to growth, but will add progressively to costs with the ageing of the population;
- The fiscal and external rooms for maneuver built during the high growth period are reaching their limits at the moment the cyclical slowdown is affecting incomes and expenditures with a risk of an end to the exceptionally easy external financing conditions (US monetary adjustment); thus financing constraints will also reappear to affect banking stability (through the fragility of their loan portfolios) in spite of their sound present positions;
- The deterioration of the prospects will affect the investment ratio, reducing the embodied technical progress, thus worsening the productivity gap, increasing the social frustrations and the domestic political difficulties at the moment; uncertainty towards reform implementation has curbed demand for expansion.

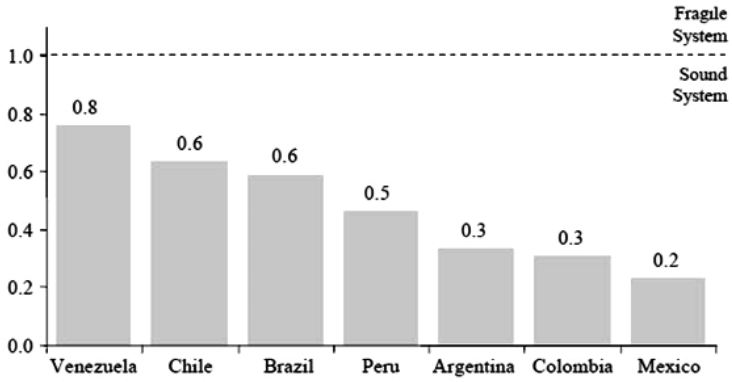
These fragilities already at work, as the CELAC area is growing at a meager 1% in 2014 and is expected to recover slightly at only 2%, but the region is differently affected according to the set of policies adopted in the past.

According to Brookings/CERES research[8], Latin American economies, while affected by common external forces, which determine a clear pattern of co-movement in the regional fluctuations, present varying degrees of overall macroeconomic vulnerability, which divide the region into three prototypical clusters: one with the Pacific pumas, sharing sound macroeconomic fundamentals (Chile, Colombia, Mexico and Peru); one with weak fundamentals (Argentina and Venezuela); and the largest one, with mixed fundamentals (Brazil).

Five charts are sufficient to capture the relative positions and the most probable prospects, making it clear that the four pumas of the Pacific Alliance make the difference and open the way. These Brookings charts represent four indicators of vulnerabilities applied to the LAC 7 countries, plus the macroeconomic forecaster consensus for the years 2014 to 2018. The 4 vulnerability indicators are: for the banking sector (projected bad-loans with respect to loan-loss provisions and bank capita), the international liquidity position (short-term total debts to external reserves), inflation (forecast for 2016 with respect to 4%), and fiscal position (debt ratio in 2030 with respect to 50%).

Charts 3: Brookings/CERES figures 1 to 5
(Source: E. Talvi, Economic and Social Policy in Latin America Initiative - ESPLA)

Figure 1. Banking Vulnerability Ratio
(BVR, Mar-2014)



8. Ernesto Talvi, *Latin America Macroeconomic Outlook A Global Perspective, Macroeconomic Vulnerabilities in an Uncertain World: One Region, Three Latin Americas*, Brooking-CERES Economic and Social Policy in Latin America Initiative (ESPLA), Washington, September 2014.

Figure 2. International Liquidity Ratio
(ILR, Dec-13)

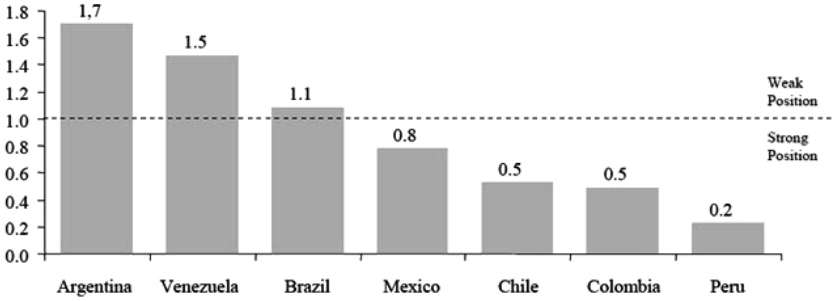


Figure 3. Inflation Vulnerability Ratio
(IVR, quadratic scale)

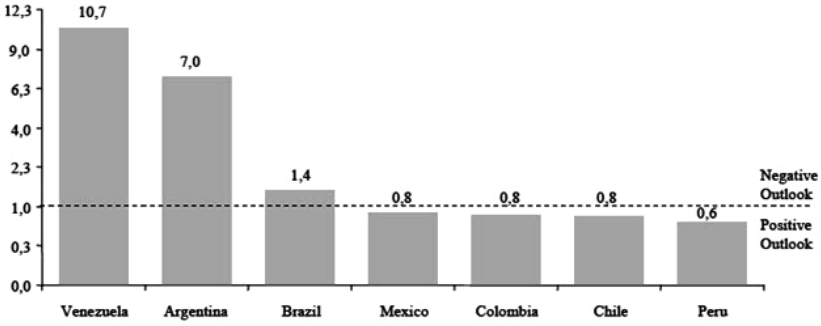


Figure 4. Fiscal Vulnerability Ratio
(FVR, quadratic scale, Dec-2013)

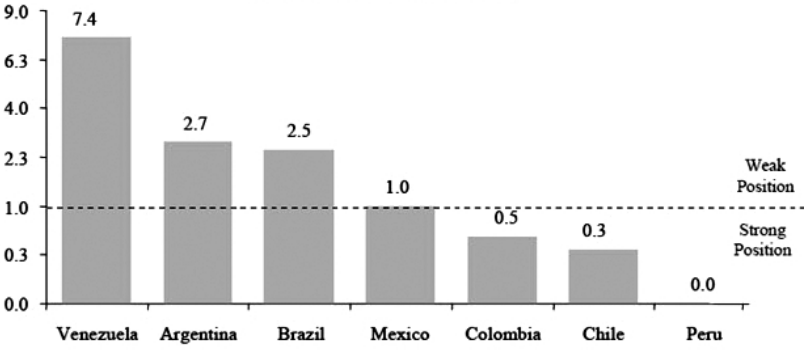
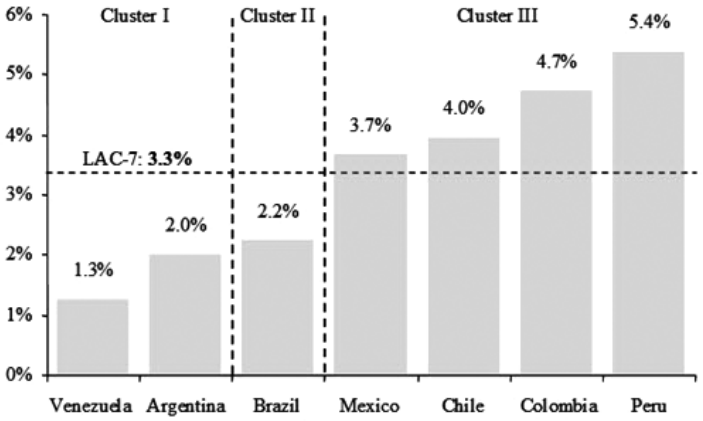


Figure 5. The Growth Outlook for Latin America: 2014-2018
(Annual GDP growth, avg. 2014-2018)



Not surprisingly, market consensus forecasts confirm the picture given by the vulnerabilities rating and the Brookings groups in the three categories of economies. Interestingly, the four best economies belong to the Pacific Alliance (PA), while the three lagging ones are from MERCOSUR. The main difference between the two regional schemes is the economic set of policies. The PA members enjoy full access to international markets and multilateral financing and strong macroeconomic fundamentals, while the same is not true of the MERCOSUR case, where the members remain very protectionist and reluctant to embrace market-oriented principles, although at a differentiated degree and for different reasons. Brazil, although having realized important reforms, remains fragile for having a weaker fiscal position and less market access, which hinders its competitiveness in global value chains.

Mexico and Brazil, which together represent two third of GDP and population of the CELAC, are contrasting examples of development policies and what can be done to reduce poverty and inequality. According to the World Bank[9], "*fiscal reforms in Mexico are creating a favorable atmosphere for entrepreneurs and are focused on reducing inequality through economic growth," ..."Brazil, on the other hand, has opted for social protection programs, focused on reducing inequality through public investment*." Our vision

9. George Gray Molina's interview, chief economist of the development program from the United Nations Office for Latin America.

is that the difference between the two development models relies more on the industrial strategies as Mexico (and the PA) tries to bet on market openness and industrial restructuration along international production chains, while Brazil is more inclined to stick to the old-fashion import-substitution route for creating national industrial clusters and export of basic commodities. Although Brazil is able to get a very high ratio of value added content in its exports, the contribution of this value-added to GDP is half of the Mexican ratio and one third of the Chinese one.[10]

It is still impossible to forecast who the winner will be, because both giants still face other common tremendous socio-political issues and governance weaknesses, but economic laws are very heavy and empirical facts from Asia (and Chile, the precursor in Latin America) show that joining supply chains is drastically faster and surer than the old way, which in fact impedes acceding to competitive conditions to dynamic part of the global value chains. The developing nations that coherently adopted this new strategy –the "*new join-instead-of-build development paradigm*" (Baldwyn)–were all successful up to now. More recently, Brazil's performance is not so convincing as, for example, China's procurement policies with Brazil have limited its ability to add value to raw material exports, making Brazil fall to the lowest rungs of the value-added ladder in its trade with China in recent decades.[11]

Furthermore, the prospect for a (much) less dynamic global context for several years, combined to negotiation run on "mega-treaties" both on the Atlantic (TTIP) and Pacific (TPP, RCEPT) rims expose Brazilian (and Argentinian) options for MERCOSUR to let their economies out, discriminating against themselves much more than the Members of PA--which all opted for integrating better into "global value chains" and took measures inside the PA[12]– and which are already integrated into NAFTA and EU Associations, and even for 3 of them into Asian trade negotiations. In such a prospect, MERCOSUR would probably be forced to adjust in the strategic self-interest of

10. RUTA, Michele, & Mika SAITO (2014), « Chained Value » in Finance & Development, vol. 51, n° 1, March.

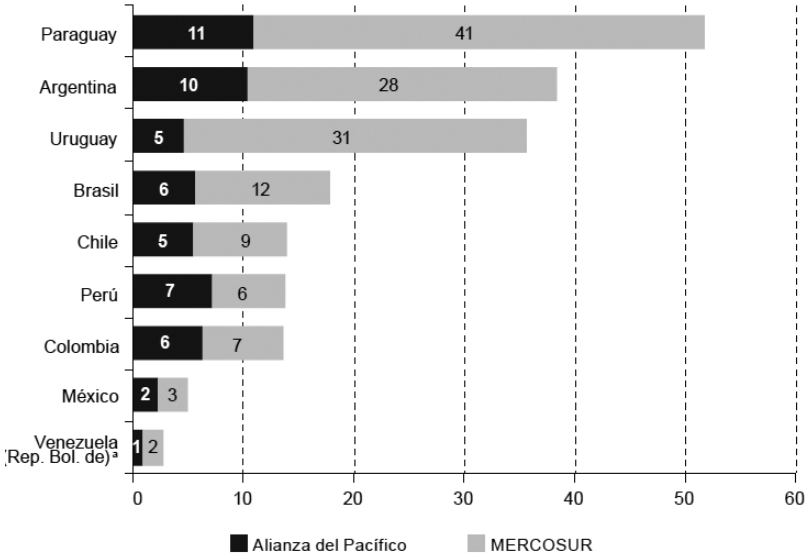
11. Gary Gereffi and Timothy Sturgeon, "Global value chain-oriented industrial policy: the role of emerging economies," in *Global value chains in a changing world*, Edited by Deborah K. Elms and Patrick Low, WTO, Switzerland, 2013.

12. The PA Trade Protocol signed in February 2014 established an agreement on rules of origin which includes an accumulation mechanism aimed at enhancing international production chains. This innovation, already in place in the Mexico-Central America Free Trade Agreement of 2011, contributes to the convergence of preexisting Preferential Trade Agreements. In addition, the PA members are promoting integration in coherence with GVCs through the elimination of restrictions on trade in services and on capital movements.

its members. The fate of the whole CELAC area will depend on the way both models– PA global option and MERCOSUR protectionist option (and their two respective Latin giants) –will find out for converging in the two years to come. But time is running…globalization gives to policy decisions, more consequences and faster effects than how it used to be in the past.

Even if the PA economies are much sounder than the MERCOSUR ones, they also depend significantly on the other CELAC economies through their own effective integration in trade, investment and industrial strategies across the sub-regional borders: the intraregional trade among PA members is extremely low (less than 4%), although in strong expansion. As chart 4 shows, Chile and Colombia depend more on MERCOSUR than on its PA partners, for example. Overall, their successful upgrading in the international production specialization (Global Value Chains) requires a deeper integration with the already existing industrial links with Brazil and other MERCOSUR members. Therefore, THE economic future of the PA implies that MERCOSUR must soon realize that the competitiveness of its economies depends as much upon a better regional integration than with third blocs as the EU and Asia.

CHART 4: Shares of intraregional trade in PA and MERCOSUR as a % in total country exports
(Source: La Alianza del Pacífico y el MERCOSUR, ECLAC/CEPAL, 2014)



This is why the EU and the PA have common interest to an agreement with MERCOSUR, as well as with North Atlantic (TTIP). The bi-regional Summit diplomacy is therefore a key instrument for putting in motion a win-win game for all these actors. Before presenting this strategy, it is important to review some features of the international insertion of all the CELAC economies, which are the roots of the vulnerabilities of the whole region.

Section 2: The genuine cause of the weak growth path of all CELAC economies: their weak insertion in international trade and their insufficient regional integration

The theoretical foundation of the positions taken in the present work relies merely on the implications of the new round of far-reaching transformation at work behind the so-called "globalization" that R. Baldwyn coined as the "**second unbundling**." It explains the supply chain fractionalization –the functional unbundling of production processes– which is governed by a fundamental trade-off between specialization and coordination costs. This globalization of supply chains –or the fact that production stages previously performed in close proximity are now dispersed geographically–shifts the locus of international competition from sectors or goods to stages of production or specialized tasks. Therefore, the old Ricardian principle of comparative advantages still applies but to tasks and not to goods, and faster than before. The supply chains also internationalize the complex two-way flows of goods, information, investment, training, technology and people that used to take place previously only within factories or between domestic plants.

Today's global economy is characterized by **global value chains (GVCs)**, in which intermediate goods and services are traded in fragmented and internationally dispersed production processes. In particular, advances in technology and an enabling policy environment have allowed businesses to internationalize their operations across multiple locations in order to increase efficiency, lower costs and speed up production. Businesses today look to add value in production where it makes most sense to do so. Analysis of GVCs implies identifying "value-added trade." This has shown two important features: (i) deep regional integration is necessary for better participation in GVCs with third partners, (ii) services account for almost half

of world trade –considerably more than traditionally estimated using only gross flows statistics. The issue is not just quantitative. The nature of the contribution of services is also important. Services are often produced in conjunction with goods and represent crucial production components for competitiveness and potential sources of innovation and value-added trade. Global investment and trade are inextricably intertwined through the international production networks of firms investing in productive assets worldwide and trading inputs and outputs in cross-border value chains of various degrees of complexity. Such value chains (intra-firm or inter-firm, regional or global in nature, and commonly referred to as Global Value Chains or GVCs) shaped by TNCs account for some 80% of global trade.

This second unbundling –initiated by Asian economies, and in which the CELAC region participates somewhat poorly–revolutionized development options faced by less-developed nations. Before the rise of global supply chains, nations had to build a deep and wide industrial base before becoming competitive. This is the way the United States, Germany, Japan and the four first Asian tigers did it. With the second unbundling, nations could industrialize better by joining international supply chains (Baldwin, 2011b). Joining supply chains is drastically faster and surer than the old import-substitution route and the "cluster vision." This new reality also transformed the political economy of policy reform, shifting attention towards the "*trade-investment-services-IP nexus*" (Baldwyn) which implies specific policies for effective regional integration, trade facilitation and free access to the best inputs (including services) and technologies (including FDI), better governance, infrastructure and logistic efforts, competition regulation, and R&D strategies. As formulated by R. Baldwyn[13], "*The 21st Century regionalism is not primarily about preferential market access as was the case for 20th Century regionalism; it is about disciplines that underpin the trade-investment-service nexus. This means that 21st Century regionalism is driven by a different set of political economy forces; the basic bargain is "foreign factories for domestic reforms" not "exchange of market access.*" Strategic links are created between companies regardless of territory and distance ("de-verticalization"), which questions the interest

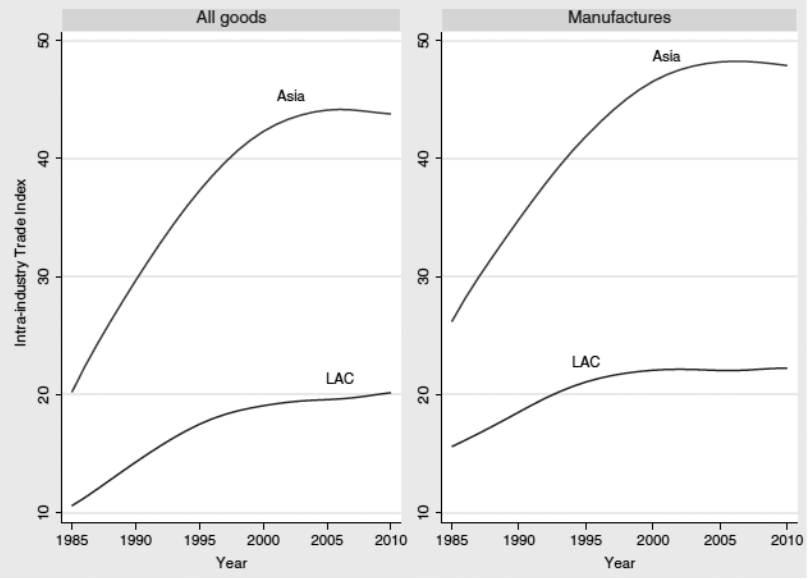
13. Richard Baldwyn, "21st century regionalism and global trade governance», on VOX CEPR's Policy Portal, May 2011.See also Baldwin, R., 21st Century Regionalism: Filling the gap between 21st century trade and 20th century trade rules, CEPR Policy Insight N°56, London, May 2011.

on simple tariff unions and protectionism based on the concept of vertical industrial "clusters." In turn, GVCs reinforces the importance of services, infrastructures, and governance, and thus of a deeper regional integration; that is, one that isn't limited to the trade of goods but also of services, and the harmonization of rules and policies. The reality of trade development in terms of GVC makes import liberalization regimes the key to the success for sustainable exports. This new feature makes the real difference between the chances of success of the different integration schemes that divide the CELAC region.

Latin American economies have always participated to GVCs, but any analysis of Latin American trade (taken as a whole) shows –whatever the criteria–that this participation has not been so favorable to its own economic development. The old structuralism doctrine used to blame the market system and trade itself, advocating for protection and creation of national clusters. The failure of this "inward-looking" strategy and the counter-example of Asian successes with "outward-looking" policies demonstrate that international insertion quality and its impact upon development depend mainly on domestic policy choices. The participation of Latin America to GVCs indicates resilient weaknesses: a low degree of trade openness and bad quality of trade structure by-products, by destination and by firms. This region is clearly lagging behind other emerging countries, especially the Asian region, for its participation in GVCs. Furthermore, Latin America is trapped in a center-periphery dependency, even with other emerging economies like China, showing counterproductive effects of protectionist strategies.

One of the most illustrative measures of this inadequacy of the region participation to GVCs is the intra-trade indicator (chart 5), since a deeper integration to international production networks implies specialization in intra-sectorial goods, rather than inter-sectorial.

CHART 5: Index of intra-industry trade as a proxy for sequential output links (index Grubel-Lloyd at 4 digits); (source: IDB[14], 2014)



The CELAC region has largely missed the recent surge in the international fragmentation of production although it has always been participant in GVCs, but mainly as a supplier of raw materials and basic inputs. This region –excepting partially Mexico and Central America–has not been able to capitalize on the recent surge of production fragmentation. Indeed, the various available indicators[15] confirm the general perception that Latin America tends to participate less than other regions in global value chains, particularly in value chain segments related to the manufacturing sector. Latin American countries participate more than Europe and Asia in international value chains as suppliers of primary inputs, while Europe and Asia participate more than Latin America as suppliers of manufacturing inputs with high, medium, or low technological content.

14. Juan S. Blyde Editor, Synchronized Factories Latin America and the Caribbean in the Era of Global Value Chains IDB, Washington, 2014.

15. Juan S. Blyde *Synchronized Factories ....op. cit.;*

Deborah K. Elms and Patrick Low *Global value chains in a changing world*, 2013, *op. cit.*

CHART 6: Blyde's Indicator of participation to GVCs: Foreign value added (blue) and domestic value added used in third countries' exports (green) as a share in value added generating sector; average 2003-2007
(Source: J. Blyde, IDB[16])

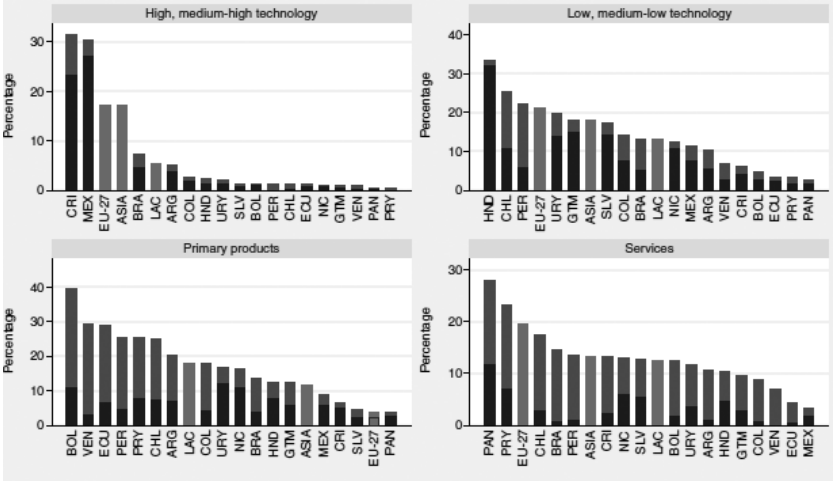
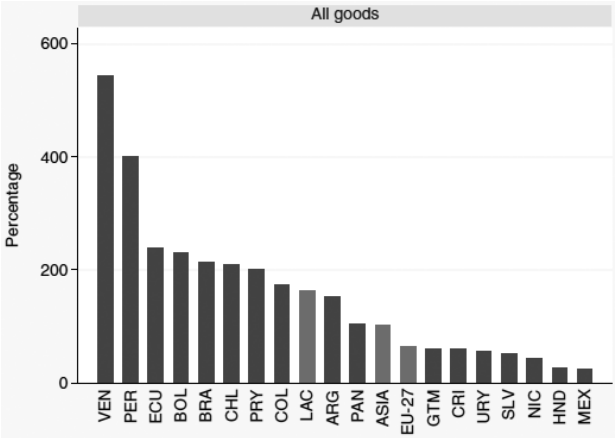


CHART 7 : Koopman's Indicator of GVC position, average 2003-2007: percentage of a country's exports used as inputs in the exports of other countries, divided by the foreign value added of the country's exports
(Source: J. Blyde, IDB)



16 Juan Blyde, IDB, *op. cit.*

Mexico and Central America are more at the end of supply chains, and South America more at the beginning. However, as a whole, Latin America is positioned further upstream in global supply chains than the EU and Asia due to the average specialization of the region towards natural resource intensive sectors. Furthermore, even for those at the downstream end their share of the value added inside the GVCs has not increased or even decreased, indicating a weak market power, making it difficult to upgrade along the GVCs. In particular, they are more confronted with Asian competitive pressure on their export markets.

While the proportion of respective value added in trade is a sign of production integration between countries, intensive trade in natural-resource-based manufactured goods tends to denote a low quality degree of such integration. As explained by ECLAC/CEPAL, "*it is thus not just a matter of joining value chains. The challenge is to increase the share of value added generated locally and to move up the chain hierarchy from simple to more complex activities. This process is neither straightforward nor spontaneous…..*" "*A key objective for Mexico and the Central American countries is to position themselves in more sophisticated links higher up value chains –whether in industrial goods or services– in which they are already present. For South America the main challenge would appear to lie in incorporating links with greater value added into natural-resource-based exports and in promoting networks and chains in the manufacturing and service sectors.*"[17]

Globalized trade opens the opportunity for changes in the economy, increasing productivity through the diversification of exports, accompanied by better links with the local economy and its services, specifically through innovative SMEs, and a better distribution of income, many times associated to the development of female entrepreneurship. However, although it is true that globalization and its "unbundling" wave offer the region opportunities for quick development, it also exposes it to new risks. The first is that it directly penalizes the protected or less developed economies, which lack the response capacity of its production apparatus, and also proper institutions to clear the obstacles to trade, which would allow a sustainable insertion in GVCs. These countries pay a "competitiveness penalty" caused by border segmentations due to tariffs, non-tariff barriers, inadequate regulations and bureaucracies, which hinder not only trade, but also the flow of information, knowledge and technology, as well as direct investment. The second is the risk of new asymmetries through the relation of power that could manifest in the capture of

17. ECLAC/CEPAL, Regional integration: towards an inclusive value chain strategy, Santiago de Chile, May 2014.

added value within each global chain, benefitting the more advanced companies, to the detriment of the smaller ones that operate in more heterogeneous economies that are less integrated with their neighbors (as is the case with many CELAC countries). Globalization thus increases the penalties over economies characterized by a low level of real regional integration, creating a vicious circle that could worsen an already backward situation, if there isn't a proper regional (and bi-regional and multilateral) cooperation strategy.

The ECLAC works for mapping the GVCs in the CELAC area show this inadequate quality of insertion according to several indicators. For example, intermediate goods[18] account for a significantly larger share of exports in the North American, European and Asian value chains than they do in CELAC area and the proportion of semi-finished goods (versus more elaborated industrial goods according to the technology content) in these intermediate exchanges is also significantly larger (66% when taken Mexico out of the region) than in the three other regions (around 30% and even 20% for ASEAN +3). Also, other CEPAL indicators[19] show a general regression in the participation of the CELAC region in the intermediary goods exported both to the region itself and to the world. The same negative evolution in the years 2000s appears in the market share for services exports and in the exports of parts and components, both indicators of participation in GVCs. Furthermore, CEPAL shows that the depth of the production chains are lower than the other regions; they have a lower degree of linkages in the domestic economies.[20] First, the proportion of firms that export is very low, at less than 1% in most of the countries for which information is available. Second, exports are heavily concentrated among a small number of highly internationalized large firms, usually associated with natural resources. The top percentile of exporting firms account for over 70% of all shipments in Argentina, Venezuela, Chile, Colombia, Mexico, Paraguay, Peru and Bolivia. Turnover among the region's exporting firms is high, one reason being their heavy reliance on a small number of products and destination markets. Another example of the lack of adequate integration due to domestic policies is the fact that Brazil imports little of intermediate goods from other countries in the region (only 5% of its industrial inputs are imported).[21]

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18. ECLAC/CEPAL, *Latin America and the Caribbean in the World Economy in 2013*, Santiago de Chile, 2013.

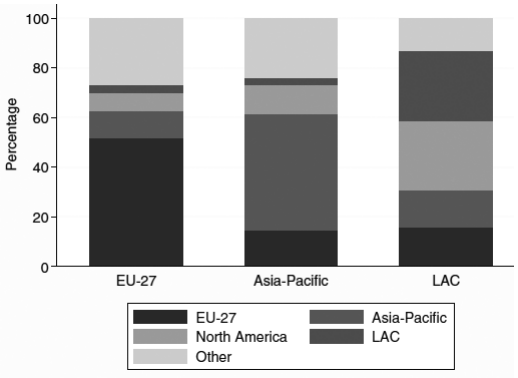
19. ECLAC/CEPAL, *Comercio internacional y desarrollo inclusivo : Construyendo sinergias*, Santiago de Chile, April 2013.

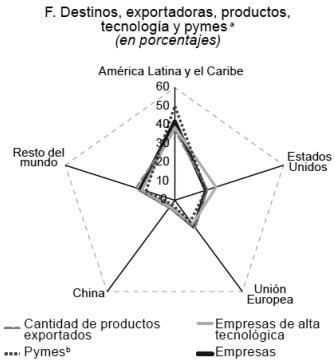
20. *Ibid.*

21. ECLAC, *Latin America and the Caribbean*…. *op. cit.*

Another pattern of the GVCs is the dominant regional weight in the composition of the chains: participation to international production networks is more intense among countries of the same region than with other regions. The within-region participation in the EU, Asia-Pacific, and LAC is 51 %, 47 %, and 29 %, respectively. LAC area is clearly part of the "North-America fabric", and also adds a similar share with its own regional chains, giving half of the networks to the Americas. The EU share (blue) inside LAC takes a slightly more important weight than Asia (red). Inside the European GVCs, LAC is more important than Asia while in Asian GVCs. LAC is the smallest partner, reflecting a LAC-Asia trade pattern that is markedly inter-industry. Since regions take an important weight in value added trade, it is all clear that in LAC the lower weight of regional contribution to GVCs is a handicap for a better position in GVCs, both being due to the low regional integration in LAC. The same conclusion comes about the LAC-Asian trade relations which are less favorable to LAC development (see chart 9 from CEPAL, where the highest distance from the center indicates a better degree of inclusive trade).

CHART 8: Regional contribution to foreign value added Chart 9: quality of trade pattern for being pro- average 2003–2007
(source: J. Blyde IDB) development (source: ECLAC/CEPAL)[22]





22. ECLAC/CEPAL, ECLAC/CEPAL, *Comercio internacional y desarrollo inclusivo: Construyendo sinergias*, Santiago de Chile, April 2013.

The analysis of value added trade and GVCs dynamics are still in progress, and the results of the existing data remain difficult to interpret, as they are influenced by contradictory factors such as the degree of openness, the size of the economy, the nature and degree of participation in GVCs with respect to the degree of their value added in exports by third countries etc…The key question is whether the growth of global value chains is generating wealth in the countries that make up the chain. The answer is clearly yes, but positive results are not automatic and require specific policies.

Anyway, empirical works allow for identifying a link between fast economic development and poverty reduction with increasing participation into GVCs. Even though some countries take on low-value-added assembly tasks, their exports still generate a substantial portion of their income–that is, they have a high ratio of value-added exports to GDP[23], and these economies are also those that have been growing relatively fast since the mid-1990s. This suggests that there are important learning effects and other kinds of positive spillovers on the rest of the economy that come from anchoring a country to global value chains. For example, local firms in countries that specialize in assembly may indirectly benefit from exposure to new technology used by foreign firms, or the improved business environment associated with foreign investment.

As demonstrated by the UNCTAD[24], for the developing country as a whole, their share in global value added trade increased from 20% in 1990 to 30% in 2000 to over 40% today. In this development the role of Transnational Corporations (TNCs) is instrumental, as countries with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs, and a greater relative share in global value added trade compared to their share in global exports. In all developing countries, value added trade contributes some 28% to countries' GDP on average, as compared with 18% for developed countries. Furthermore, there appears to be a positive correlation between participation in GVCs and GDP per capita growth rates. Economies with the fastest growing GVC participation have GDP per capita growth rates some 2 percentage points above the average. It is clear that LAC region is still lagging in adopting this strategy with respect to other emerging economies.

23. RUTA, Michele, & Mika SAITO (2014), «Chained Value» in Finance & Development, IMF, vol. 51, n° 1, March.

24. UNCTAD, *Global Value Chains and Development: Investment and Value Added Trade in the Global Economy*, Geneva, December 2013.

The conclusion is that for the CELAC area, trade patterns and especially the kind of insertion in global trade imply asymmetries which impede a faster growth. This conclusion is not new, as largely developed by the "structuralist school" of Latin-American economists[25], but the substitution of imports proposed by this doctrine as a remedy to asymmetries led to a worsening of the under-developed insertion of this region. Therefore, as shown by the evolution of the CEPAL school towards a new structuralism[26] based upon the theories of endogenous growth and the open regionalism, the key is to change domestic traditional protectionist policies based upon static "geographic cluster" strategies for spurring a better participation in global trade based upon trade openness and effective regional integration. Achieving a production transformation that helps to reduce inequalities requires more and better-quality productive employment and a greater presence of SMEs, manufactures and services in exports. These are better represented in intraregional trade than in any other kind of trade. Consequently, there is a direct link between a strategy of growth with equality and the strengthening of the regional economic space.

In fact, the productivity gap between the modern export sector and the rest of the economy reveals a heterogeneity in the sector, called "internal gap" given the low productivity that affects most of the economy; this generates social inequalities, which in turn slows down progress in productivity and innovation, leading to the so called "external gap," or lack of structural competitiveness, due to exports with low impact on growth and social progress (less inclusive exports and international insertion). Large internal gaps reinforce the external gap, and partially feed on it. Thus, vicious circles are created, not only in terms of poverty and low growth, but also slow learning and weaken structural changes, all of which hinder regional integration and reinforce their handicap in competitiveness, which limits their ability to insert themselves into value chains under good conditions. Since low productivity sectors have great difficulties in innovating, adopting technology, and driving learning processes, the internal heterogeneity worsens systemic competitiveness issues, poor international insertion and social exclusion.

This complex vicious circle, which slows down the region's development, is evident in the fact that even a boom in exports and foreign opening doesn't sufficiently translate into an internal chain of activities linked to exports, thus

25. For examples ECLAC's authors like R. Prebisch, C. Furtado, O. Sunkel, A. Pinto.

26. Neo-structuralism launched with the doctrine of "Productive Transformation with Equity Policy", see ECLAC's authors like R. FFrench-Davis, J. A. Ocampo, F. Fajnzyilber.

explaining the lack of progress in the total potential output of the domestic sector and the stagnation of total productivity. In that way, non-inclusive growth doesn't change the structure of the economy and its competitiveness that doesn't move forward CELAC economies in the "international hierarchy" of their global insertion.

Technical studies by ECLAC on the region's low quality of international insertion reinforce the interest that the new (neo-structuralist) approach poses for Latin America and the Caribbean. Several ECLAC studies have evaluated the quality of exports and the specialization patterns, as well as the types of insertion of the region, and conclude that "*the traditional comparative advantages based on the export of natural resources are increasing again, and the progress made is still unsatisfactory, since in several cases trade has not reduced imbalances or structural heterogeneity.*"[27] This "re-primarization" is more than the price-effect, it is also a step backwards for some products that were displaced by China. ECLAC also highlights "*the little participation in global value chains and the limited depth of internal linkages.*" Indeed, as demonstrated by ECLAC[28], the asymmetries are evidences of integration failures in the periphery areas, both internally (heterogeneities between sectors, income-earners and workers, sub-regions and economies) and externally (national market segmentation together with low competitiveness and poor productivity). The underdevelopment vicious circle is explained by a productivity gap between the export sector and the rest of the economy, which means sectorial heterogeneities creating an "internal gap," leading to rising social inequalities; in turn, these inequalities impede labor mobility, education, innovation and productivity progress, leading to a worsening of the "external gap" in productivity with the developed areas, maintaining unfavorable asymmetries with an export structure less beneficial for domestic economies and less inclusive, maintaining internal gaps. Such a vicious circle, impeding changes and endogenous growth, is visible in the absence of progress in total productivity, reinforcing the internal and external gaps and impeding structural change in the external sector and upgrading in the GVCs participation.

In particular, poor CELAC performance in total productivity is a symptom of the perverse effects of policies which explain the inadequate participation to and upgrading along GVCs. Thus it is clear that an external opening –although

27 ECLAC/CEPAL, Comercio internacional y desarrollo inclusivo : Construyendo sinergias, Santiago de Chile, April 2013.

28. ECLAC/CEPAL, *ibid*.

necessary, as shown by the relative success of the PA economies–is not in itself sufficient to achieve a quality international insertion. Proper strategies and policies are additionally required to accelerate both regional integration and insertion into global chains. It is precisely this double and simultaneous dimension which can foster both the Strategic Alliance of CELAC with the EU and the Chilean strategy expressed in its new motto proposal for the PA –"*Convergence in diversity.*" Indeed, for the PA, an association agreement between MERCOSUR and the EU would ease this highly needed convergence between Pacific and Atlantic coasts i.e. between MERCOSUR and PA, which in turn would pave the way for the Strategic Alliance between the whole CELAC and the EU. Of course, these forces, although at work, face counteracting vested interests and inertia in collective minds and political ideas.

Therefore, the PA –which corresponds to a new regionalism driven by a different set of political economy forces shifting the attention towards the "trade-investment-services-IP nexus"–appears as a fundamental catalyst for triggering a broader win-win game based upon a quadruple strategic argument:

- the PA attracts strategic FDI from the rest of the world, creating pressures for an upgrading of economic policies in the CELAC area and a convergence between MERCOSUR and PA schemes;
- because the slow growth of CELAC could be tackled through a specific strategy combining a deep regional integration together with an upgrading inside GVCs;
- these two ingredients characterize precisely the EU cooperation and its external policy, because these elements are also in EU interests;
- also, for bargaining better results in the TTIP with the US not only for the EU members but also for CELAC by preventing discriminatory effects upon MERCOSUR if an association agreement could be agreed soon, an additional argument for incentivizing convergence by the inevitable opening of MERCOSUR to both the EU and the PA.

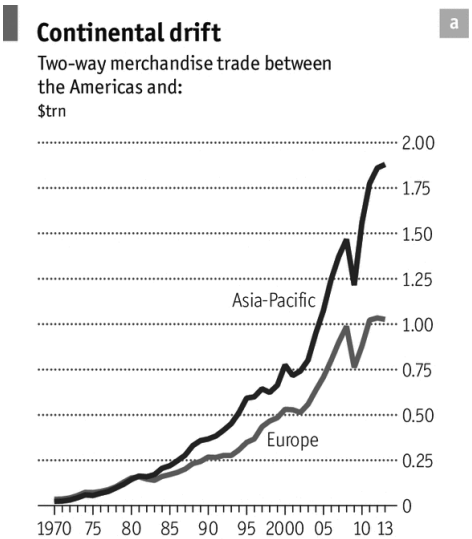
Section 3: Which strategy the EU should adopt with the CELAC economies?

The few facts and explanations given in section 2 about the GVCs impacts upon the international economy indicate the crucial importance and the urgent need for the CELAC area to quickly design and implement a coherent strategy for tackling its poor insertion in the global economy. This section 3 presents the paradoxical thesis that the cyclical growth slowdown and the

unresolved governance difficulties affecting the CELAC partners, are not obstacles for making them ideal candidates for a deep Strategic Alliance with the EU, which is also facing difficult times with stagnant growth and poor productivity performance threatening their own position in GVCs.

In fact, rather than being an obstacle to cooperative strategies, difficulties and challenges faced by both regions are, on the contrary, driving forces for strengthening their cooperation. CELAC economies' handicaps in global insertion and in governance represent additional reasons for launching a new cooperative alliance with the EU: the fundamental reason is the dynamic convergence of interests in both regions that could be put in motion for reaping the benefits of their complementarities…if adequate instruments of coordination and cooperation are in place. The historical chance is precisely that with the 15 years of Summit Diplomacy, the required coordination instrument is at hands at the very moment policymakers of both regions are facing serious challenges. For both regions these challenges call for a change in their international bargaining positions for upgrading their insertion in GVCs, as well as for facing on a better foot the Mega-regional-trade negotiations the other global powers are presently managing. There is a need for bi-regional policy cooperation for improving the respective insertions in GVCs, which tend to be led by the Pacific Rim powers, and reverting the growing gap which is not in the Atlantic Rim's favor (see chart 10). This cooperation, betting upon mutually attractive complementariness in the kind of international insertion in global competition, could tackle two closely related issues: the respective poor productivity performances in CELAC and EU regions, and the required upgrading along GVCs, which implies taking part in Mega-regional-trade negotiations for ensuring a stronger position in the Pacific Rim growth factory, as well as progressing in the regional integration in the CELAC area.

CHART 10: The Pacific growth factory
(source: the Economist, 15th November 2014)



Source: IMF, Direction of Trade Statistics

Respective competitiveness of both CELAC and EU economies are about to be affected by the ongoing negotiations towards "Mega-regional-free-trade agreements" which are deeper agreements that change the conditions for spurring GVCs development. The dominance of GVCs in shaping trade, investment, technology transfers and productivity growth made competitiveness dependent more upon a lot of non-trade barriers and other domestic factors as legal security and business climate. Therefore, the kind of new trade rules required by GVCs are often negotiated within these Mega trade agreements out of the multilateral scheme of the World Trade Organization. These deep agreements often include legally enforceable provisions that tend to establish disciplines that are broader in scope than under multilateral agreements. Deep agreements, moreover, often contain legally binding obligations on a range of issues not currently regulated by WTO that are relevant to the functioning of value chains. These include the treatment of foreign investment, competition policy, government procurement, capital flows, environmental and labor regulations, measures relating to the granting of visas and regulatory convergence.

In a survey of 96 free trade agreements covering 90 percent of world trade, the WTO[29] found that the core rules introduced in these agreements govern competition policy, intellectual property rights, investment, and movement of capital. For instance, 73 percent of agreements in this survey contain obligations on competition policy outside the current WTO mandate. Therefore, the pattern of these Mega-trade agreements will change competitiveness of insiders with respect to outsiders to these agreements, forcing latecomers to adopt rules negotiated by others, and giving to leaders of these Mega-agreements decisive "first-in" competitive advantages. It appears that both CELAC regions and the EU face a risk of regulatory fragmentation, or even exclusion. Hence, they have a mutual interest in coordinating their positions in order to try to have a say through their respective involvements in these agreements. In particular, since some members of CELAC are not part of–either directly or indirectly–TTIP, TPP, RCEP; while the EU is not part of the Pacific Rim negotiations, an obvious common concern deserves to be considered for the agenda of the CELAC-EU Summits. Also, they could, if they joined forces, have a crucial weight and be able to find ways to "multilateralize" these free trade agreements and make them coherent across countries.

In fact, the present world configuration of GVCs is schematically divided in three major production networks ("factories"): Factory Europe (Germany being the hub), Factory North America (based in the United States) and Factory Asia (originally centered in Japan, and more recently in China). The functioning of the GVCs requires some discipline and regulation, creating a demand for governance that the impasse at the WTO Doha Round has increasingly forced to be satisfied by separated deep trade and investment agreements between Mega-regions. The competition between the three factory-centers leads presently to a competition between negotiations on regulations for imposing their own standards. The CELAC area, which belongs mainly to the North American factory, offers the peculiarity of having access to the two other global factories, although the quality of exchanges is better with the EU than with Asia (with which the degree of inter-sectorial trade is higher). This should attract CELAC more towards the EU than towards Asia.

The existence of EU growth difficulties tends to make EU policymakers more inclined to look for better access to new markets, while CELAC policymakers are more in need of getting better access to GVCs and technology

29. World Trade Organization (WTO), World Trade Report: The WTO and Preferential Trade Agreements: From Co-existence to Coherence, Geneva, 2011.

transfers by benefitting from the experiences and cooperation of their European partners. The contribution from EU cooperation to CELAC is especially important for contributing to the virtuous relationship between competitiveness and internationalization. Improving competitiveness implies for both regions to improve education and innovation, two key-aspects in which bi-regional cooperation can make a difference for both sides. Research needs diversification for increasing innovation capacity, especially for SMEs, which represent the bulk of the productivity gaps with the two other factories and between EU and CELAC, as well as inside both regions. Only a specific set of coordinated policies at the bi-regional level (which supposes previously an effective intra-regional coordination) could enable SMEs to internationalize and reach new markets. In turn, internationalization stimulates the competitiveness of SMEs by making them operate in more complex markets and giving them access to new technologies, business practices, networks and market information, among other resources. This internationalization could be faster for both regions in the context of their bi-regional cooperation for acceding to GVCs. Indeed, participation in GVCs is also a powerful tool for the internationalization of SMEs, which can gain access to these chains through direct or indirect exports; that is, by supplying goods or services to larger export firms. Experiences from ASEAN countries[30] show that the highest rates of SMEs participation in production networks were in countries that are more fully integrated in such networks.

The fact that the Pacific Rim has become the driving force of the world economy justifies a specific interest from both regions in getting privileged access to these markets through better participation in GVCs. Joining their complementarities would make more competitive CELAC and EU economies together in the global competition, allowing them to improve their participation in common GVCs for competing in the Pacific Rim. This strategy means spurring the evolution from an inter-industry trade pattern to a more intra-trade structure, with an upgrading mainly for CELAC economies, but contributing to improve their joined participation to whole GVCs in mutual interests. Such an objective requires a specific cooperation in education in science & technology for spurring innovation, one of the priority topics of the bi-regional cooperation.

30. Ganeshan Wignaraja, "Engaging small and medium enterprises in production networks: firm-level analysis of five ASEAN economies," ADBI Working Paper Series, No. 361, Tokyo, Asian Development Bank Institute.

The Summit Diplomacy has reached effective results for making more explicit the mutual interests as well as for stimulating intra-CELAC coordination. It provides the optimal instrument for upgrading the existing bi-regional cooperation in order to face common threats. These risks come from the new global economy with Mega-regional negotiations, which expose both regions to a Pacific Rim led by two dominant powers. The EU external policy offers to the CELAC partners the kind of instruments, experiences, like-minded perspectives and mutual respect they require, and which the two other powers do not provide to the same degree. In particular, the shared objective to create a "common higher education space" is part of the purpose of the Strategic Alliance.

Building a Strategic Alliance CELAC-EU for strengthening their mutual competitive insertion in dynamic GVCs should be the priority for the Brussels Summit of 2015. The operational foundations rely in the conjunction of several features and pragmatic considerations when considering the CELAC region with respect to alternative partners:

- The shared values and the common society objectives of both regions, that no other region could offer with the same degree of affinity; this provides a worthy asset for integrating GVCs, since a crucial part of the costs of coordination depend upon trust by sharing some common identities and cultural links;
- The structural weakness of CELAC region's involvement in GVCs offers enormous potential complementarities in their mutual interests for improving their respective productivity, thanks to specialization along common "global value chains" offering an effective strategy for facing global competition by strengthening joined competitiveness of both partners in a cooperative win-win-game;
- The accumulated experience in LAC-EU cooperation and instruments which combines reciprocal cooperation, trade openness and regional integration, all the more with the recent creation of the CELAC for Latin American and Caribbean countries speaking with a single voice, and the EU-crisis, which rebalances the bi-regional relation by making more symmetric the dialogue between both partners;
- The CELAC-EU cooperation provides a broader range of tools and experiences than it might be the case with other regions for tackling the urgent need for the CELAC area and its sub-regions in their efforts to integrate their economies for improving their efficiency and being able to upgrade their participation into GVCs. This is particularly the

case in EU cooperation, with its priority given to regional integration, to SMEs development and to education and social cohesion; also the trend in developing "Aid-for-trade" instruments and the existing availability of this kind of instruments with positive recent experiences; EU cooperation could answer to the urgent need to internationalize SMEs of both regions for breaking the productivity gap of SMEs; CELAC area's SMEs could reap faster and higher gains from joint-ventures with EU's SMEs, integrating them into business networks in a single market of 500 million consumers, favoring their upgrading inside GVCs; the existence of EU experiences should orient the existing tools available for the EU-CELAC cooperation policy towards SMEs support;

- The fact that European FDI and "Translatin" firms have already built business networks and some starting bases for integrated production chains;
- The present strength and momentum of the Pacific Alliance (PA) model of growth which will allow for the Pacific coast recovering a more attractive growth for EU firms participating actively through exports, FDI and joint-ventures;
- The urgency and logical reasons for expecting soon some convergence between this PA model and the MERCOSUR one, taken on board the geo-political dynamics in a fast moving global competition.

These factual reasons associated with the global forces driving the new economy along GVCs open an attractive road of mutual interests based upon complementary needs of both regions for breaking vicious circles of low internationalization, low SMEs productivity and low innovation capacity in order to increase their stagnant total factor productivity and the potential output. Adopting an ambitious active cooperation strategy at a micro level between firms, at research level in building a common space in education, science & technology, as well as at a macroeconomic level through a policy dialogue, is the fastest way to meet the social challenges of globalization. The simple picture of the relative poor performance in R & D efforts in both EU and CELAC economies with respect to Pacific powers indicate (see Chart 10) the need and urgency for common action for drawing upon the new knowledge economy.

CHART 11A: Total Expenditure on R&D as a percentage of GDP, average 2005-2012
(Source: La Alianza del Pacífico y el MERCOSUR, ECALC/CEPAL 2014)

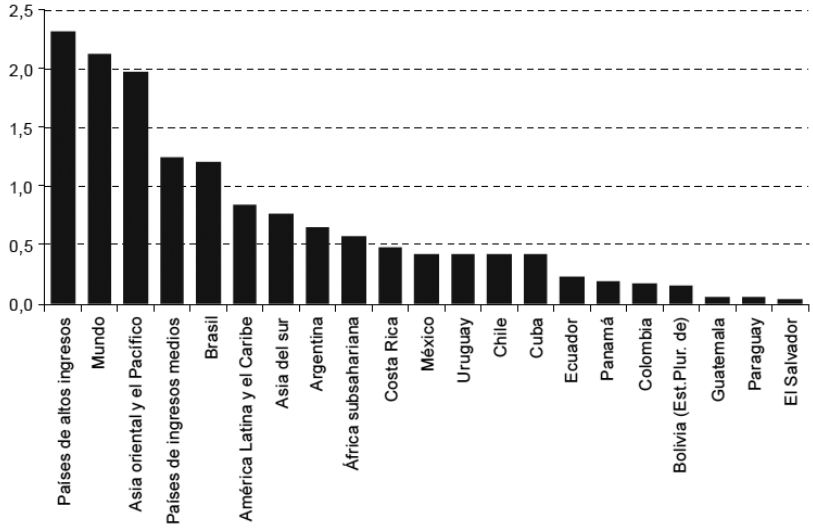


CHART 11B: Business Expenditure on R&D (BERD) as a percentage of GDP, 2002 & 2012
(Sources: OECD, ECLAC, CAF, Latin American Economic Outlook 2015, Paris, 2014)

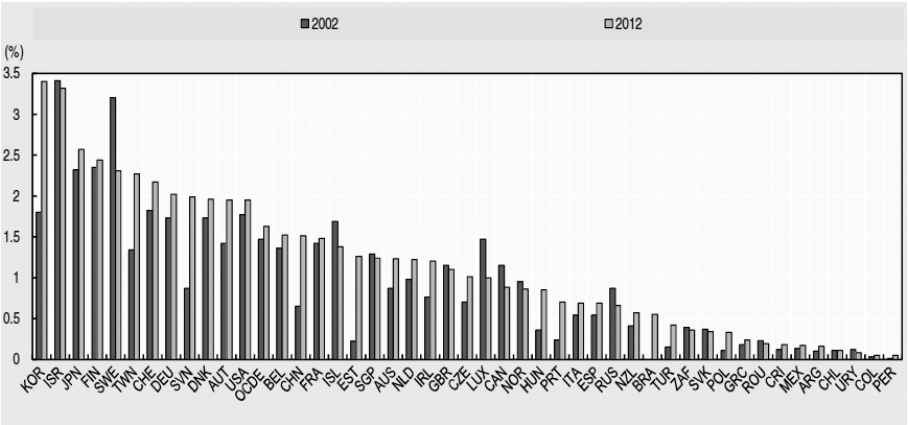
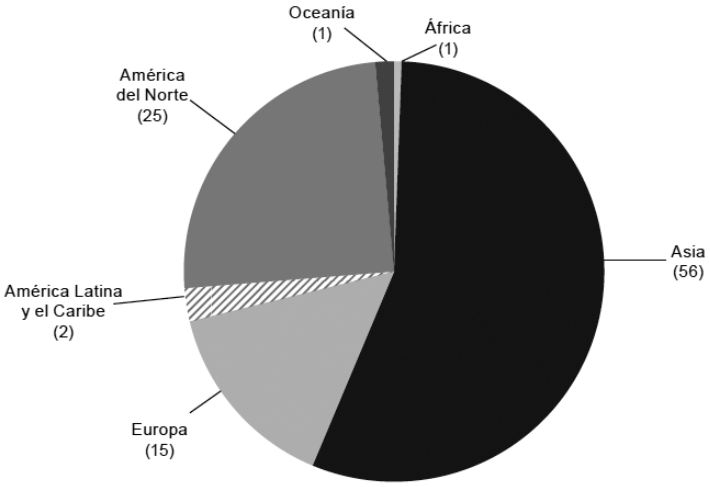


CHART 11C: Deposit of Patent claims by region in % of the world
(Source: La Alianza del Pacífico y el MERCOSUR, ECALC/CEPAL 2014)



Of course, upgrading the agenda for the Summit and its Action Plan CELAC-EU still requires further works from diplomatic, academic and policymakers. Deep and intensive research on both regional sides for identifying concrete common actions and for adapting existing cooperation instruments and budgets should be launched in the context of the results of the Brussels Summits (not only the Heads of State and Government, but also the parallel Academic, Business and Civil Society Summits) and the preparation of the next Summit. However, the most important step is to make policymakers aware there is no time for procrastination: the Summits offer the right tools in the right moment for designing the multi-annual road-map for a building a new partnership with this CELAC region, which is the EU's genuine ally for the XXI century globalization.

4. THE PACIFIC ALLIANCE (PA) POTENTIAL ROLE: ITS INTERESTS FAVOR CONVERGENCE WITH MERCOSUR AND PARTNERSHIP WITH THE EU

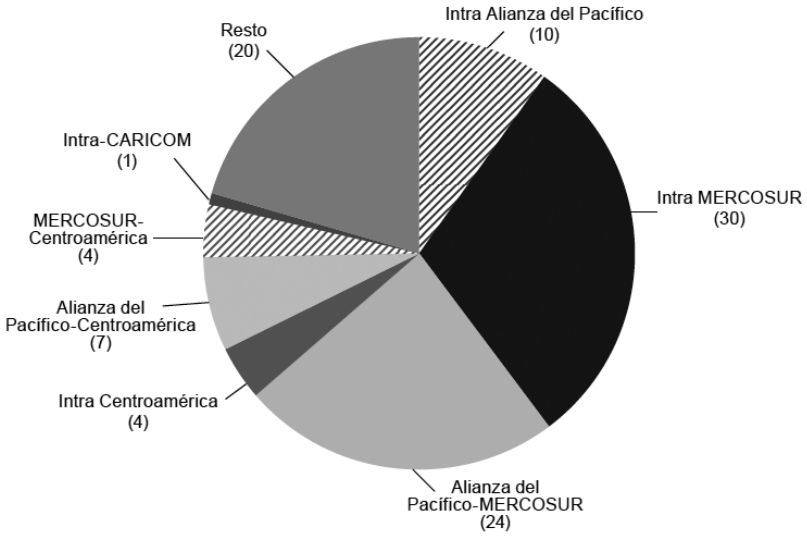
From this broad panorama of the new features of the CELAC economies, the "Four Pumas" forming the present PA emerge as a new power able to give

impulse to a new momentum in the CELAC region and its external relations. Indeed, the formation of the PA means a consolidation of a model of international insertion into the global economy with Mexico, Central America and the Caribbean, which is opposed to the MERCOSUR model. This consolidation represents an important step towards more adequate agreements for upgrading participation in GVCs by focusing more on regulatory convergence towards deep integration by covering issues such as trade in services, investment, competition policy and public procurement. The PA integration scheme groups the present best performers, which are also perceived as enjoying the highest rate of growth for the next future. However, this is clearly insufficient: neither the Atlantic nor the Pacific coast can do without the other in the global economy. Both sides of the region have specific advantages and should coordinate to maximize their potential access to GVCs. As claimed by President Dilma Rousseff, "*Our continent has the fortune of standing between two oceans. The future of Latin America depends on our ability to bring these seas together.*"[31]

The previous analysis shows that the PA performed much better than the MERCOSUR region. However, the production structures of its four present members present lower interdependencies than these members already have with MERCOSUR partners. Chart 12 shows that the trade between PA and MERCOSUR is 2.4 times more important than what it reaches inside PA. Although the real intra-integration process is just starting among PA members and will increase fast, it remains that their economies and models are competing between them, which implies further institutional progress. It is highly probable that PA has used up the easiest part of its process, and now faces a more difficult step for ensuring its progress upwards along the GVCs, an urgent necessity for ensuring a sustainable path to of total factor productivity. But the effective stage of productive integration in the PA and its dimension are two limiting factors for pretending to be able to create their own GVCs or to bargain successfully in the existing ones, especially with the giants of the Pacific Rim.

31. President Dilma Rousseff at the first regional meeting of the Clinton Global Initiative, 9 December 2013,Rio de Janeiro.

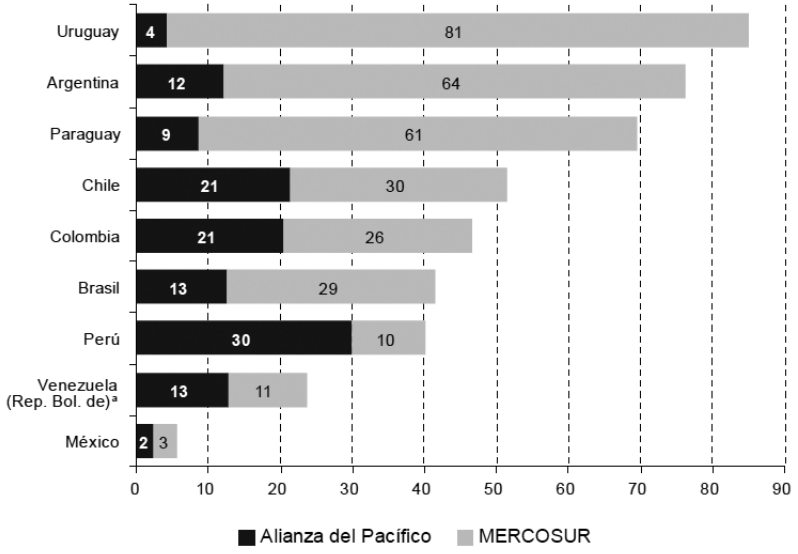
CHART 12: CELAC intra-regional trade structure, in % by sub-region
(Source: La Alianza del Pacífico y el MERCOSUR, ECALC/CEPAL 2014)



On the contrary, as visible on Chart 12 and 13, the productive links are significant between the PA and the MERCOSUR. In the exports of manufactured goods with technologic content, Chile, Colombia and even Mexico export relatively more to MERCOSUR markets than to their own PA markets. CEPAL has also shown that the importance of intra-sectorial trade (parts and components) is very low inside the PA, but not negligible between the PA and MERCOSUR (Brazil role). CEPAL identified the potential trade between both sub-regions, which reaches 17% of their total trade.[32] This structure offers a strong basis for developing regional production chains and inserting them in the GVCs.

32. CEPAL, La Alianza del Pacífico y el MERCOSUR, ECLAC/CEPAL, Santiago, Chile, 2014.

CHART 13: Shares of PA and MERCOSUR exports of manufactured goods with medium-to high technology content (in % of their total exports of these goods)
(Source: La Alianza del Pacífico y el MERCOSUR, ECALC/CEPAL 2014)



Therefore, it is clear that the strategic interests of the PA members are to develop deeper integration with MERCOSUR, of course, without renouncing the advantages of their global openness which are needed for global competitiveness.

This convergence between the two schemes is inevitable for several reasons.

First, it is an obvious common interest to both schemes to find out an agreement for developing their mutual trade when they consider, as demonstrated by CEPAL, that intra-CELAC trade is more differentiated and intensive in manufacturing, with a higher technologic content, higher accessibility to SMEs, and more job-creating and trade with non-CELAC partners.

Second, it is not only an issue of trade policy (tariff and protection) since competitiveness of GVCs depends also on regional infrastructures, logistic services, energy and communication, norms and regulations. Therefore, there is a wide scope for mutually beneficial cooperation and harmonization between both regional schemes, which does not imply MERCOSUR should abandon its own trade policies, but would strengthen both partners in the global competition. For example, reaching a system of mutual recognition of regulations would be a significant progress in real integration in CELAC. A

step further would be to harmonize the two systems of rules of origin and to converge towards a common accumulation mechanism.

Third, as regards the handicap in science and technology, which is the key to further developing productivity, both regions cannot solve it alone, but could coordinate their own policies for improving information and specialization, preventing a duplication of efforts and benefitting economies of scales. It is the same with industrial strategies. Both sub-regions need some kind of non-national industrial policies. An exchange of information across sub-regions would be mutually beneficial in basic aspects, where common interests are clear and favor cooperation, such as training for internationalization of SMEs, data basis, analysis of obstacles to trade etc., allowing for introducing a system of burden sharing as a first step towards coordination.

To these objective reasons for taking steps towards this "convergence in diversity," both sub-regions add their own motivations. For the PA, it is the intrinsic logics of its openness to trade and investment which requires broadening its economic basis towards its CELAC partners. For MERCOSUR, additional reasons come from the fears of the Mega-treaties under negotiations (TTIP, TPP and RCEPT) which will expose its members to discrimination and trade diversion. In the new configuration of global competition along complex, growing international networks of production directly influencing Mega-regional trade agreements, the CELAC economies have no other choice than to first encourage their own regional integration in a way that is compatible to upgrading their respective positions on the GVCs by structuring them around the two largest economies, Brazil and Mexico. Indeed, intraregional trade has characteristics that make it qualitatively superior to exporting to other markets, since Latin American market is the most conducive to export diversification, SMEs participation and to structural change. Nevertheless, both largest economies require a rapid diversification for their more effective insertion into the global economy.

Mega regionalism poses a challenge to CELAC policymakers and obliges them to deepen their own integration process as a tool for improving their economies' participation in the world economy. This strategy implies that the two main economic integration schemes–MERCOSUR and the Pacific Alliance–converge rapidly together with an involvement in the ongoing Mega-regional negotiations, and especially the conclusion of a MERCOSUR-EU association agreement. It is especially crucial for preventing MERCOSUR members from suffering too many discriminatory effects from the regulatory impacts of other mega-regional negotiations. The best solution for MERCOSUR is obviously to join agreements with both the EU and the PA in order to strengthen its position both in North Atlantic and in the Pacific.

5. Conclusion

Unfortunately, the CELAC area is divided in two main integration schemes reflecting two different sets of policies and international insertion. This division between the Pacific coast and the Atlantic one has discourage the development of regional or sub-regional value chains, making more difficult to be competitive and to upgrade into dynamic Global Value Chains (GVCs). The embryonic national systems of innovation are not integrated and cannot be sufficient to fill the technology gap.

The success of the Pacific Alliance (PA) integration scheme merely, but significantly, reflects the success of the stability reforms these four countries were able to implement and sustain for decades. The PA is the demonstration of the two fundamental laws that regional integration[33] is only feasible when macroeconomic policies converge for ensuring credible stability, and that in the present globalized world, regional integration focuses less upon tariffs and customs unions, than rather upon an institutional building process for making room for regional cooperation in almost all policy areas in order to ease the regional competitiveness.

The slow growth of CELAC could be tackled through a specific strategy combining a deep regional integration together with innovation policies for upgrading their value added inside GVCs, both ingredients that characterize the PA needs and what the EU association agreements offer with their cooperation and foreign policy. The reason is merely that these elements are also in the EU interests, making it possible to have a nice win-win geo-political game. Indeed, changes linked to "unbundling tasks" give both regions the possibility to aim at a greater complementarity of their companies in several sectors, generating common comparative advantages before third parties, such as China and the United States. This industrial recombination in both regions –associated with the development of investments between both regions, which since the Santiago Summit became a new chapter in bi-regional Lines of Action–would have more chances for success if it were part of the CELAC-EU bi-regional cooperation framework, rather than with any other regional strategic alternative, since it is based on shared cultural and "societal" values compared to other regions or third powers. Likewise, the interest of Europe is to find complementary business partners in a cultural environment with shared values, in a zone of relatively fast sustainable growth and along the path of integration, where its companies

33. Ghymers, Christian, REDIMA, *op. cit*., CEPAL, 2005.

can continue expanding, offering applied technologies in exchange. This would allow the economies of CELAC countries to move forward regarding the productivity of their SMEs, as well as to establish links with the regional and international economies, while counteracting the trends towards re-primarization that affect several economies in the region.

In spite of drawing upon their 15 years of bi-regional Summit Diplomacy, the Brussels Summit of June 2015 missed a historic chance for the CELAC and EU policymakers to create a coalition of interest for competitiveness improvement in both regions by upgrading their mutual GVCs participation with technology transfer in exchange for joint ventures, crossing FDI and other production and research partnerships. Indeed, for CELAC economies, the cooperation with the EU for getting better access to their markets and activities (acceding directly to higher technologies, directly addressing 500 million persons and the largest exporter in the world) and to the EU cooperation tools and experiences (on regional integration, SMEs support and internalization, training and education, science & technology, aid-for-trade, social cohesion, better partnership in their technologic advances in their existing GVCs) constitute the best option they could get in comparison with the two other global fabrics and the kind of alternative agreements they might offer. For the EU, facing stagnant domestic economies and low productivity development, accessing a deeper integrated market of 600 million persons and benefitting from complementary position of CELAC economies in GVCs, as well as a platform towards the Pacific Rim, also represent the best option for consolidating the European competitiveness in the global economy, while bolstering their best geo-political allied countries. The PA partners could act as a catalyst for making a triple deal PA-MERCOSUR-EU, which would strengthen the EU position in the TTIP.

Such a strategy is not a naïve cooperative proposal, but a very realistic combination of mutual interests based upon complementarities for resisting to third power competitiveness and the urgent needs to make compatible the regulation implications of the competition between Mega regional negotiations. These challenges cannot be met alone, neither for CELAC nor for the EU. What really makes the difference favorable to a CELAC-EU strategic partnership for GVCs upgrading is the balanced dialogue provided by the Summit Diplomacy for focusing EU cooperation tools and budgetary resources upon a common GVCs strategy for exploiting complementarities and upgrading international insertions. This target must become the top priority for giving an operational content to the bi-regional Strategic Alliance.

CHINA AND THE PACIFIC ALLIANCE: FROM MARKET SHARING TO INDUSTRIAL INTEGRATION?

Jorge Heine, Wu Guoping and Li Renfang

On 18-26 May 2015, Prime Minister Li Keqiang undertook his first official trip to South America, visiting Brazil, Colombia, Peru and Chile. In so doing he was joined by a high-level official delegation that included Foreign Minister Wang Yi, Commerce Minister Gao Hucheng and the Minister in charge of the National Development and Reform Commission (NDRC), Xu Shaoshi. A business delegation of CEOs and executives of some 120 Chinese companies also joined him. The visit attracted widespread attention not just in the Latin American and the Chinese media, but also in the international one.[1]

Much of this attention was focused on the proposed bi-oceanic, trans-continental and trans-Amazonic railway project that would connect the port of Santos in Southern Brazil with a yet to be determined port in Northern Peru. This would be perhaps the most ambitious infrastructure project ever undertaken in South America. It was first mooted by President Xi Jinping during his visit to Brazil in July 2014, and the pertinent feasibility studies are being undertaken, under the supervision of a tripartite committee made up by Brazil, China and Peru. But this massive, 5000 km project (for which 2000 km are already in place) was by no means the only large-scale item on the agenda of the visits. In Brazil, a US$ 53 billion dollar package of deals was announced by PM Li and President Rousseff, including the sale to China of

1. News coverage was extensive, but see, for example: EFE, "Gira del Primer Ministro chino vuelve a resaltar interés por Latinoamérica", 17 May 2015; Alma Lopez Figueiras, "China busca afianzar su influencia en América Latina con inversiones en la región", *El* Mundo, 17 May 2015; Carlos Aquino, "China Still an Engine for Latin American Ggrowth," *China Daily,* May 21, 2015, p. 9; and Jorge Heine, "Latin America can Aid China's Transition," *China Daily,* 22 May 2015, p.9.

a significant number of medium-range passenger planes from Embraer, the Brazilian aviation giant.

In Colombia, the initiation of negotiations for an FTA was announced, while in Peru a number of important industrial and mining joint ventures took center stage. In Chile, some 18 agreements were signed, including one to avoid double taxation, another to deepen the extant FTA and, perhaps most significantly, several between the People's Bank of China and the Central Bank of Chile that will make Chile the regional platform for the RMB in Latin America. At ECLAC headquarters in Santiago, Prime Minister Li delivered a major address on Sino-Latin American relations, pointing out they are entering a new phase.[2]

In short, this was arguably the most significant visit by a Chinese delegation to Latin America from an economic standpoint. And apart from the visit to Brazil, a continent-sized nation that stands on its own in the South American mainland, it included three of the four members of the Pacific Alliance (PA): Chile, Colombia and Peru (the fourth, Mexico, was visited by President Xi during his very first visit to the region in 2013). This should not be surprising. With a population of 214 million, the PA represents little over a third of the population of Latin America and the Caribbean (LAC). Its economies make up 37 per cent of the regional product. If the member states of the PA were to merge into one, they would be the eighth largest economy in the world and the eighth largest exporting power, with a foreign trade of US$ 1.1 trillion in 2013. Beyond these numbers, what makes the PA especially attractive is its dynamism and openness. According to the World Bank, of the 32 countries in the region, those of the AP are ranked as numbers 1, 3, 4 and 5 among those with which it is easiest to do business. In addition to a highly favorable business environment, AP member states also have more open economies, that took up 50 per cent of the region's foreign trade in 2013. They also attracted 45 per cent of FDI into the region that year, for a total of US$ 85 billion dollars, and 33 million tourists. The per capita income of these countries as a whole is US$ 10,249 dollars.[3]

In this context, the PA offers considerable potential for Chinese companies interested in doing business in Latin America, as well as a significant

2. On the visit to Chile in particular, see Heraldo Muñoz, "China, un hito en Chile", *La Tercera*, 30 May 2015.

3. For an earlier piece on the subject by the same authors of this article, see our "China y la Alianza del Pacífico", *CHINA HOY*, Vol. LVI, # 1, January 2015, p. 14-16, from which we draw.

focus for Sino-Latin American financial and industrial cooperation, with many investment possibilities. The purpose of this chapter is to examine that potential and what it entails. A first section is devoted to the new Chinese foreign policy under President Xi Jinping and to how Latin America fits in it; the second provides a brief discussion of the state of Sino-Latin American relations, within which those of China with the PA are embedded; a third parses the PA's economic trade ties with China; a fourth deals with new trends in the international economy and their impact on Sino-PA economic and trade cooperation; a fifth one analyzes the prospects for enhancing the latter in the short and medium-term, while a sixth and final one discusses how trade and economic cooperation can be fostered through cultural exchanges and talent development.

I. A New Chinese Foreign Policy

A new, more assertive foreign policy has emerged under the government of President Xi Jinping. This policy is aimed at harnessing the two key forces shaping the early part of the new century–globalization and multipolarity.[4] The new China that has arisen in the course of the past three-and-a-half decades is one of the great beneficiaries of globalization–i.e. the swift increase in the trans-border flow of goods, services, capital, data, cultural products and people that mark our age. By opening up its economy, deregulating it and letting the fresh winds of the market unleash the entrepreneurial spirit that has always marked the Chinese people, China has made enormous strides, to the point it has become the second largest economy in the world and has triggered a massive reduction in the poverty rate. Yet this enormous progress and the much larger weight that the Chinese economy carries in the world today (representing around 16 per cent of world product, *vis a vis* some 22 per cent for the United States), has not gone hand in hand with commensurate changes in the mechanisms of global governance. The latter have largely failed to acknowledge not just the rise of China, but also the rise of other emerging powers in the new century, creating a large gap between international economic reality and the institutions that govern it.

4. For an informative text on this new foreign policy, see Wang Yi, "Toward a New Type of International Relations of Win-Win Cooperation," a speech given by the Foreign Minister of China at a Luncheon of the China Development Forum, Beijing, March 23, 2015.

It is into this breach that Chinese foreign policy has stepped in, making the case for a new approach to the management of international relations. This approach aims for a middle ground between hegemonic stability theory, on the one hand, and global governance, on the other. It stands instead for "win-win cooperation." Based on the recognition that "globalization has made countries increasingly interconnected and their interests more than ever intertwined," it starts from the premise that cooperation is the way forward for progress to occur. At the same time, it also tries to stay away from what it considers to be a false choice between confrontation, on the one hand, and alliances, on the other, as is often posited in more traditional approaches to international relations. Instead, it identifies building partnerships as a key task. These partnerships are forged at the bilateral and multilateral levels, as well as at the regional and global ones.

The 22nd APEC Summit, held in Beijing in November 2014, is considered by some to have been a sort of coming out party for this new foreign policy, and is a prime example of the resonance this approach has found. Attended by some of the world's main leaders, it examined key topics for the economies of the Asia Pacific like regional integration, innovative development, connectivity and physical and digital infrastructure. The main Chinese proposal, that is, to give the go-ahead to the feasibility studies for the creation of a Free Trade Area of the Pacific (FTAAP), was unanimously approved by the 21 member countries.

Something similar can be said about the creation of the Asian Investment and Infrastructure Bank (AIIB). In a context in which it is estimated that Asia will need US$ 8 trillion in infrastructure spending over the next decade, for which the funds and programs from existing multilateral institutions like the World Bank and the Asian Development Bank are woefully inadequate, China proposed the creation of a new institution to help cope with this enormous deficit. Unsurprisingly, there was pushback to this initiative from the United States, which is widely rumored to have advised its allies to stay away from it. Yet, the *prima facie* case for the AIIB, in terms of its helping to increase productivity and connectivity in the world's fastest growing and most dynamic region, one on which so much of the rest of the world depends on, was so strong, that leading U.S. allies (headed by the United Kingdom) soon rushed into joining the AIIB in March 2015. Based in Beijing, and to be launched in 2016, with a capitalization of US$ 100 billion dollars (of which half are to be

provided by China) the AIIB is bound to make a significant contribution to development projects in Asia in years to come.[5]

In the same vein, the proposal to create a New Silk Road, through the "Silk Road Economic Belt and the 21st Century Maritime Silk Road," has also been well received, with some 60 countries signing up for it. With the ambitious goal of recreating Eurasia, it would entail building multiple economic corridors–some on land, and some sea-based–from China all the way to Europe, facilitating commerce and connectivity, fostering growth and narrowing development gaps, while also bringing resource-rich Central Asia into the equation. A New Silk Road Fund would supplement the funds available from the AIIB for the railway lines, highways, ports, tunnels, and bridges such a mammoth undertaking would demand, while FTAs between China and the countries located along this route would further facilitate trade, commerce and investment.

Some of these projects may work out, others may not. Our point, however, is that, at a time when the developed countries around the North Atlantic are focused on their own internal challenges, Chinese foreign policy, based on the principle of "win-win cooperation," is putting an ambitious international agenda on the table and backing it up with the resources to finance it.

And it is in this context that we have to examine the changing nature of Sino-Latin American relations, to which the government of President Xi has given considerable priority–so much so that he undertook two major visits to the region during his first 18 months in office.

II. The Next Phase in China-Latin American Relations

For Latin America and the Caribbean, the first decade of the 21st century was marked by the boom of the Asian economies, particularly by that of China. Trade flows between the Asia-Pacific region and LAC grew by 20.5 percent a year between 2000 and 2010, with two-way commerce reaching US$ 442 billion in 2011, of which China accounts for half. By now, Asia accounts for 21 percent of LAC's foreign trade, trailing only the United States with 34 percent.

5. See Jane Perlez, "Xi hosts 56 Nations at Founding of Asia Infrastructure Bank," *The New York Times*, June 29, 2015.

Trade with China saw a real explosion, increasing from US$ 10 billion in 2000 to US$ 260 billion on 2014, a surge of 2600 percent. By 2011, China had become the largest export market for Brazil, Chile and Peru, and the second largest for Argentina, Venezuela, Cuba and Uruguay. The impact on economic growth was direct, through China's huge demand for primary commodities such as copper, iron ore and crude oil and foodstuffs such as soy and fresh fruit to fuel its rapidly growing economy and feed its now prosperous population of 1.36 billion people. China's impact was also indirect, through upward pressure on commodity prices.[6]

Now that the Chinese economy settles into the "new normal" growing at 7 percent rather than at 10, commodity prices have softened, and the LAC economies have felt the impact. LAC's projected 2015 growth is 0.4 percent, a far cry from the 5 percent it averaged in the 2003-2008 period.[7]

For some, this means that "the party is over," and that now that the commodity super-cycle is past its prime, Sino-LAC relations will go back to square one, i.e., to the rather low-profile, low-significance affair they were twenty years ago. Yet that would be a mistake. The challenge now is to adapt to, and make the most of, this new environment. And this means institutionalizing China-LAC links, and taking them from the current condition, i.e. one based mostly on trade, to deeper and stronger ones, adding investment, technology transfer and financial and other types of cooperation across a vast array of fields. This was the key purpose of the First China-CELAC Foreign Ministers Forum held in Beijing on 8-9 January 2015. CELAC, launched in 2010, embodies Latin American regionalism at its best: it brings together all countries from the Rio Grande to Patagonia, allowing LAC to speak with one voice and to develop a common agenda with counterparts like China. One of the ambitious goals set forth at the Forum is to double two-way trade between China and LAC to US$ 500 billion; another, to double the stock of Chinese FDI in LAC to US$ 250 billion.[8]

A key challenge for LAC, whose per capita income is, on average, higher than China's, is to increase productivity. One obstacle is insufficient

6. See Cynthia J. Arnson and Jorge Heine, "Reaching Across the Pacific: Latin America and Asia in the New Century," in Arnson and Heine (eds.), *Reaching Across the Pacific: Latin America and Asia in the New Century* (2014), p. 9-30, from which we draw.

7. See Eduardo Porter, "Slowdown in China Bruises Economy in Latin America," *The New York Times,* December 17, 2015, p.B1.

8. For a variety of Chinese and Latin American perspectives on the significance of the First China-CELAC Ministerial Forum, see the special issue of *CHINA HOY*, Vol. LVI, # 1 (January 2015).

infrastructure, both physical and digital. The vast spaces of South America need to be inter-connected, and the Atlantic and Pacific coasts better linked to each other. Much as in China, it is the coastal areas that have seen most economic development, with the interior being left behind. Chinese technology, be it in railways, in construction, in telecom or in energy, can do much to overcome this. Over the past decade, China's vast landmass and its huge population have been integrated through bullet trains and mobile telephony. A similar undertaking awaits much of the interior of South America and other parts of the region.

As it happens, according to some estimates, Overseas Direct Investment (ODI) from China may soon overtake Foreign Direct Investment (FDI) into China. As the internal rate of return in China declines, Chinese companies, flush with cash, are keen to invest abroad. Increased investment flows in both directions across the Pacific, and joint ventures between Chinese and LAC companies would help to overcome the First World-Third World pattern of Sino-LAC trade extant until now, with the latter selling mostly raw materials and commodities, and the former finished consumer goods and industrial inputs, which is something unsustainable in the long run.

Thus, the end of the commodity super-cycle offers the opportunity for a major upgrading of Sino-LAC links, in which financial cooperation, investment flows and broad-based cooperation are added to trade as the main driver of the world's most dynamic region, the Asia Pacific. And it is in that task that the Pacific Alliance (PA) is poised to play a major role.

III. The Pacific Alliance's Economic and Trade Ties with China

Almost by definition, the PA is a regional entity oriented to Asia. Its strategic development goal is to provide international competitive advantage for its member states and help them integrate into the world economy–in particular, the Asia-Pacific's. It positions itself as an alliance facilitating member states' economic integration, strengthening economic and trade ties with the Asia-Pacific area and attracting investment from Asia and other regions. China, as the fastest growing economy in the Asia-Pacific area in these four decades, becomes one of the most important trading partners for the PA. Moreover, the growth of the bilateral trade and mutual investments enables the PA and China to develop closer business relations.

1. *Changes in Sino-PA Economic and Trade Cooperation*

As a booming economy, China has an increasing demand for agricultural, mining, and energy products from the PA countries. The number of Chinese tourists choosing to travel in PA countries is also on the rise. Meanwhile, the PA countries, committed to expanding business cooperation with China, wish to attract more Chinese investments and become China's platform in exploring the Latin American market. China's "going global" strategy is very much in line with the PA's development strategy of openness and cooperation.

Since the new century, this cooperation has shifted from simple business exchanges to a more comprehensive FTA-based model. Since 2005, China has signed FTAs with Chile, Peru and Costa Rica and concluded the FTA feasibility study with Colombia. With the integration of the PA countries, the Sino-PA cooperation gradually shifts from bilateral FTAs to multilateral economic cooperation. In November 2013, the 'Sino-Pacific Alliance United Business Chamber'' was set up during the seventh China-LAC Business Summit; on December 9th, 2013, the four PA countries' embassies in China jointly organized an investment and trade promotion forum in Beijng, promoting 140 billion dollars' worth of investment projects to Chinese businesses. In 2014, the alliance hosted the Forum on Entrepreneurship and Innovation, LAB4, and the second PA business matchmaking event, or Macrorrueda, and actively participated in business activities such as the China International Food and Beverage Trade Fair, indicating that cooperation between China and PA has been greatly enhanced (La Alianza de Pacífico, 2014). An investment and tourism promotion seminar was held by the PA in Guangzhou in November 2014, which elicited considerable attention.[9] The PA countries plan to launch a tourism promotion campaign as a whole in China in the latter half of 2015 so that they can attract more Chinese travelers.[10]

2. *Trade in Goods*

The bilateral trade between PA countries and China took off between 2000 and 2013, with the annual trade growth rate reaching 26.73%: the alliance's export to China grew by 26.58%, while Chinese exports to PA member

9. See Li Wenfeng, "Chile Eyes Chinese Investment." *China Daily*, 1 December 2014.

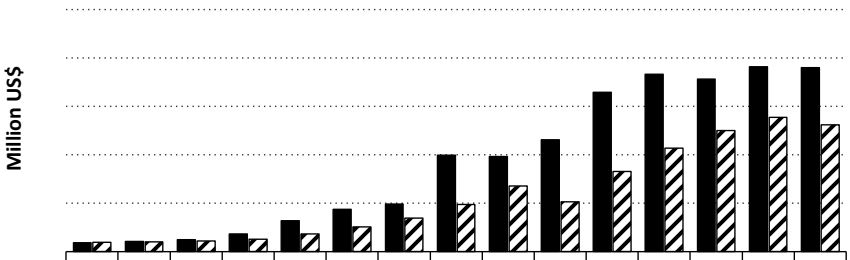
10. Article from La República, Peru, July,7,2014; cited from the article titled "PA is About to Make China its No. 1 Tourism Market," from ifeng.com.

countries grew by 27.12%.[11] Though the 2008 global economic crisis slowed down trade growth, bilateral trade exceeds US$133.9 billion dollars, twice the amount of 2008. This reflects a much higher growth rate than the one between the PA countries and other economies.[12]

As the following tables show, there are common elements, but also interesting variations, in the trade patterns between each of the PA member countries and China. A first commonality is the very rapid growth of trade from 2000 to 2014. A second is that, with the exception of Mexico, exports of the PA countries to China are largely made up of natural resources–mostly copper in the case of Chile and Peru, and mostly oil in the case of Colombia. A third is that, with the exception of Chile, the other PA members tend to run a deficit in their trade balance with China, a deficit that is especially pronounced in the case of Mexico. In terms of variations, perhaps the most revealing one is the very different degree of their respective export dependence on China. As can be seen from Table 5, whereas 24.84% of Chile's exports go to China, only 17.54% of Peru's do so; 8.67% of Colombia's and a mere 1.7% of Mexico's. Interestingly, the import dependence of these four countries on China is much more even, fluctuating between 16 and 19%.

TABLE 1

Trade Chile - China 2000-2014



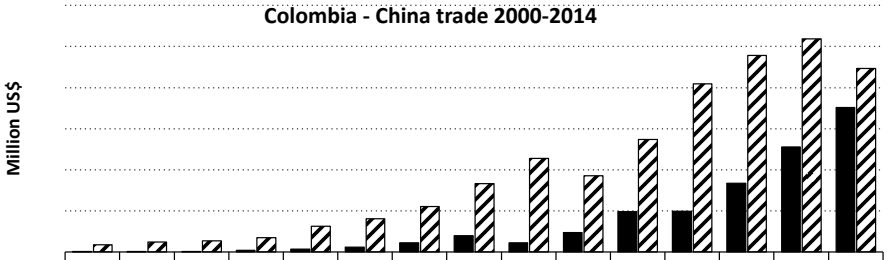
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
exports	902	1.038	1.225	1.836	3.211	4.390	4.934	9.980	9.851	11.539	16.457	18.323	17.822	19.108	19.033
imports	946	1.013	1.102	1.289	1.847	2.540	3.488	4.885	6.804	5.134	8.292	10.711	12.497	13.860	13.106

Source: Chile Customs

11. UN Comtrade.

12. From 2008 to 2013, PA countries' annual aggregate trade volume only grew at 5.32%, while its annual trade volume with China grew at 15.09%.

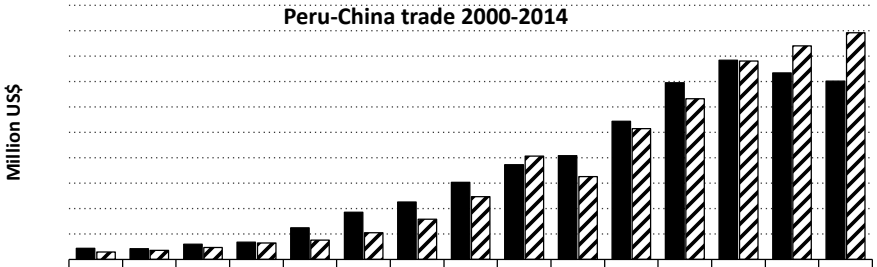
TABLE 2



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
exports	29	20	28	82	138	237	452	785	443	950	1.967	1.989	3.343	5.102	7.025
imports	356	475	533	689	1.245	1.617	2.219	3.327	4.549	3.715	5.477	8.176	9.565	10.363	8.925

Source: UNCOM TRADE

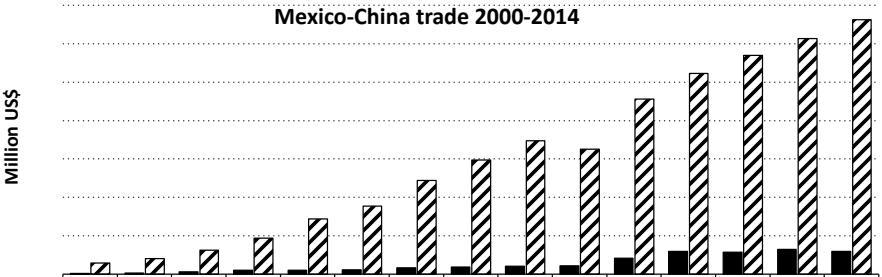
TABLE 3



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
exports	443	426	598	677	1.245	1.861	2.269	3.040	3.735	4.078	5.434	6.961	7.849	7.343	7.025
imports	289	354	463	640	768	1.058	1.584	2.463	4.069	3.267	5.144	6.321	7.807	8.399	8.925

Source: CIICEX PERU

TABLE 4



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
exports	204	282	654	974	986	1.136	1.688	1.895	2.045	2.208	4.183	5.964	5.721	6.469	5.964
imports	2.880	4.027	6.274	9.401	14.374	17.696	24.438	29.744	34.690	32.529	45.608	52.248	56.936	61.321	66.256

Source: Ministry of Economic Affairs, Mexico

In any case, there is little doubt that China in recent years has become a more significant trading partner for the alliance due to the European sovereign debt crisis and sluggish American economic growth. From 2008 to 2013, the proportion of imports from China rose from 11.7% to 17% and exports to China increased from 3.47% to 6.83%. Chile and Peru have signed FTAs with China, and their trade volume with China has accounted for a lion's share in the total volume. In 2013, China became the largest trading partner for both Chile and Peru, with Sino-Chile trade volume exceeding US$34.9 billion dollars and Sino-Peru volume exceeding US$15.7 billion dollars. The Sino-Mexico trade and Sino-Colombia trade are also flourishing, at US$ 67.8 billion dollars and US$ 15.5 billion dollars[13] respectively. Even though these two countries run a trade deficit with China, their relatively rapid growth in exports to China in these years has made China a significant export destination.

Table 5. The proportion of trade between Pacific Alliance / members and China in aggregate volume from 2008 to 2013 (%)

Year	Imports					Exports				
	CHL	COL	MEX	PER	PA	CHL	COL	MEX	PER	PA
2008	13.18	11.47	11.24	13.59	11.70	13.21	1.18	0.70	11.94	3.47
2009	14.46	11.29	13.88	14.97	13.77	23.49	2.89	0.96	15.25	5.88
2010	16.82	13.46	15.13	17.13	15.34	24.36	4.94	1.41	15.44	6.51
2011	16.87	14.95	14.89	16.75	15.32	22.86	3.49	1.71	15.25	6.28
2012	18.03	16.47	15.36	18.47	16.10	23.21	5.55	1.54	17.08	6.31
2013	19.72	17.45	16.09	19.37	17.00	24.84	8.67	1.70	17.54	6.83

Data source: calculation based on data from UNComtrade[14] database

3. Mutual Investment

Mutual investment between China and the alliance is a crucial part of bilateral economic cooperation and an important channel for the global value chain-oriented transnational industrial integration. China's Shougang Group

13. UN Comtrade.

14. The calculation of the UN Comtrade database is based on the mutual commercial trade between the four countries.

began its direct investment in Peru in 1992, but it was not until 2003 that China's direct investment in the PA countries experienced rapid growth. Most of the investments went to Colombia and Peru; in 2013, Chinese investment in Peru reached US$9,108 billion dollars, and US$3,748 billion dollars in Colombia. The numbers for Chile and Mexico are much lower. The investment in Chile, Peru and Columbia focuses on energy, mining and agriculture, while that in Mexico focuses on manufacturing. The new energy bill, aimed at reforming the domestic oil and gas industry legal framework approved in December, 2013, offers new opportunities to Chinese investors in Mexico. With the rapid growth in goods and services trade, Sino-PA economic cooperation will surely attach more importance to the global-industry-chain-oriented cross border investment, and the PA will surely be the focus of China's overseas investors.

TABLE 6. FDI from China to Pacific Alliance countries
(in millions of US$)

Country	1990-2009	2010	2011	2012	2013	TOTAL
Chile	na	5	0	76	19	100
Colombia	1677	6	293	996	776	3748
Mexico	146	9	2	74	15	246
Peru	2262	84	829	1307	4626	9108
TOTAL	4085	104	1124	2453	5436	13202

Source: ECLAC 1st Forum of China and the CELAC, 2014

Compared with China's investment in the PA, the PA's investment in China is relatively small, though it shows steady growth. As ECLAC has pointed out, one reason for that is that some areas that represent the core activities of the biggest Latin American TNCs, such as mining, are virtually closed off to FDI in China. Another reason is that many of these companies have opted for duplicating their business model (say, in retail) abroad, for which neighboring Latin American countries provide more suitable environments. As can be seen from table 3, among the PA countries, Mexico and Chile are the two heaviest investors, accounting for over 90% of the total investment. Peru and Colombia invested much less. It is expected that the mutual investment growth will pick up when bilateral cooperation deepens and greater industrial integration takes place.

TABLE 7. FDI from Pacific Alliance countries to China
(in millions of US$)

Country	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TOTAL
Chile	12	8	3	6	6	7	5	3	1	17	21	89
Colombia	0	0	0	0	0	0	0	0	0	0	0	0
Mexico	7	6	21	7	12	6	4	1	15	5	15	99
Peru	1	1	4	3	1	5	3	0	0	1	0	19
TOTAL	20	15	28	16	19	18	12	4	16	23	36	207

Source*: Inversiones de ALC en China:Un capítulo nuevo de las relaciones entre América Latina y el Caribe y China, Washington D.C.: Inter America Development Bank, 2014.*

IV. NEW TRENDS IN THE INTERNATIONAL ECONOMIC LANDSCAPE AND SINO-PA ECONOMIC AND TRADE COOPERATION

The 2008 global financial crisis has had a significant impact on the world economy and changed the international economic landscape. Links between China and PA have not been spared. Faced with these changes in the external economic and political environment and internal economic trends, both sides need to adjust their cooperation strategies accordingly.

1. *New Trends in the International Economy*

What are these new trends?

Regional economic integration has gained momentum; bilateral, multilateral and regional cooperation between emerging economies has accelerated; and cross-regional economic cooperation has come to the fore. This has helped to overcome the stalled momentum of the WTO multilateral negotiations. It has also extended international economic relations from the traditional goods and service trade to market sharing, industrial investment, intellectual property, information cooperation, tax law, and product standardization. As countries aim to increase trade and FDI and create more job opportunities, stronger cooperation becomes imperative.

In terms of the world economic structure, all major economies are now faced with the need to upgrade traditional industries and restructure global industry chains. After a period of long-term sustained growth, the slowdown of traditional industries and the decline in development opportunities make it hard to meet the demand of future economic development. To tackle this conundrum, a reconstruction and upgrading of major industries is necessary. Industrial upgrading depends on technological innovation and business model innovation, while reconstructing a value-chain based global industry is critical to improve economic efficiency, and a major reason for countries to increase cross-border economic cooperation.

In terms of the international economic cycle, the world is now entering into a stage of slower growth, as the commodity super-cycle comes to an end. Recent years have also witnessed the impact of counter-cyclical policies and major changes in world production and market structures. The share of bulk commodities in international trade is declining, and the roles of the developed and emerging economies in the world economy are changing.

2. *China's "New Normal"*[15]

Faced with these changes in the internal and external environment, China ended its era of high growth rate of ten per cent and entered a period of slower growth rate of seven per cent. Upgrading and optimizing the economic structure thus take center stage, with growth driven by innovation rather than production factors and investment. Macroeconomic policies thus need to be adjusted to adapt to the new normal.

Against the backdrop of major changes in the international economic landscape and slower domestic growth, China needs to restructure its huge international reserve assets, optimize the global allocation of these assets and increase overseas investments. This economic restructuring is not only about changes in industrial structures, but also about the composition of demand and income structure. Domestic consumption capacity will increase dramatically;

15. President Xi Jinping used the words "new normal" to describe China's economy in this new cycle in May, 2014 for the first time when he visited Henan Province. In July, 2014, President Xi mentioned in a meeting with nonparty members that "We should have a clear notion of the specific features of this stage of economic development, consolidate confidence, adapt to the new normal, and jointly promote sound and sustained economic growth." In December, 2014, he elaborated on the main characteristics of China's new normal of economic growth during the Central Economic Work Meeting.

consumption will be a major source of social demand, while demand for imports will also increase. With the gradual decline of labor cost advantages, economic growth should shift from a factor-driven model to an innovation-driven model. The readjustment and relocation of China's factor-intensive industries is unavoidable, while the transferring of excess capacity to foreign countries must also be considered. This is changing China's current cross-border economic cooperation, and will have a profound effect on its links with the PA counties.

3. *Internal Cooperation within the Pacific Alliance*

What are the main challenges faced by the PA ?

The first one is the big difference in its member states' economic and industrial development, as well as the low interdependence of their internal trade (Xie Wenze, 2014). The second is their homogeneous export structure in energy products, mining products and agricultural products (though Mexico, with its advanced industrial sector, falls into a category of its own). The third one is competition from other regional organizations such as UNASUR and NAFTA. These problems may result in internal competition for FDI and export markets, as well as unequal distribution of interests which may stand in the way of further internal integration and comprehensive economic cooperation with China.

V. Prospect for Enhanced Sino-PA Economic and Trade Cooperation

Further comprehensive economic and trade cooperation between the PA and China is crucial for both sides to adapt to the changing international economic landscape. If properly designed and implemented, this cooperation has great prospects.

1. *Mutual Development Demand*

After the 2008 global crisis, the world economy is still in the shadow of sluggish growth. The EU recession, North America's weak recovery and China's slowdown have led to lower prices of Latin America's commodities and falling exports, and to lower FDI from developed economies. To overcome

this, the PA encourages its members to partake of the benefits of Asia's growth by exporting more agricultural and manufacturing products to it, as well as attracting more investment from China and other Asian economies.

After three decades of high growth, China's demand for imports and capacity for ODI has improved greatly. Now China needs to further explore the global market, deepen its cooperation with strategic trading partners, make the most of overseas investment opportunities to export capital, promote the reasonable distribution of labor in the global market and further enhance the global value chain. The PA countries are endowed with rich natural resources and a huge market, as well as the best business environment and investment opportunities in the region, especially in agriculture, natural resources and infrastructure.

2. *Towards a Common Development Strategy*

Since 1978, China has pursued a policy of reform, openness and cross-border economic cooperation. China has thus played an active role in advancing global economic integration. A more open China has not only boosted its domestic economic growth, but has also contributed to the growth of the world economy. This has been felt in Latin America. In the aftermath of the 2008 global economic crisis, thanks to the robust growth of China and other emerging economies, the spell of economic recession in Latin America was shorter, and its recovery swifter, than in any of the previous external economic shocks. Further reforms and opening up are pivotal to sustaining China's rapid economic growth. Extensive international cooperation holds the key to win-win development of the global value chain for China and the rest of the world.

Member countries of the PA are all committed to free trade. It is their shared belief that social progress and economic prosperity can be achieved through a free market economy. Former President of Chile Sebastian Piñera once said, "Only absolute liberalization and openness are the right way forward." Colombian President Juan Manuel Santos stressed that, "If we did not open up markets, we would never find the driver for growth." Mexican President Enrique Peña Nieto believes that free trade is the key to boosting development and overall competitiveness of the entire region. Peruvian President Ollanta Humala also stresses that free trade agreement would help to

attract global investors to Peru.[16] Currently, Chile and Mexico are two of the countries that have signed the largest number of FTAs.

Promoting common development through opening up and international cooperation are beliefs shared among China and the PA countries, and the bedrock for long-term, stable cooperation. China has signed FTAs with Chile and Peru, and may soon sign one with Colombia. China is an observer country of the Pacific Alliance and has maintained good economic and trade ties with its members.

3. *Promoting Sino-PA Trade and Industrial Integration While Following the Trend of the Global Value Chain*

Cross-border economic activities usually begin with trade in complementary goods and services. Trade expansion will inevitably lead to investment, eventually resulting in increased cross-border investment in production between main trading partners. Thanks to a rapid trade expansion over the last three decades, China has become the world's largest trading nation, and its investment in its main trading partners has grown significantly. China has also opened its door to capital outflows. The Pacific Alliance should not only aim to further increase its exports to China, but should also try to attract Chinese investment, so as to reinforce the dividends it has reaped from cooperation with China. Going forward, trade and economic cooperation between China and the Pacific Alliance will gradually move up from expanding the scope of regional trade to boosting bilateral investment, and from trading complementary goods and services to promoting cross-border industrial integration.

In terms of fostering trade growth, China provides an enormous market of nearly 1.4 billion people, and its average annual import over the next five years is projected to reach $2 trillion. As mentioned above, trade between China and Latin America has been growing in leaps and bounds. As Peruvian President Ollanta Humala has said "China has become a primary export market and main trading partner for Peru and other Latin American countries. Sustained growth of the Chinese economy is not only pivotal to world economic recovery but also of great significance to economic growth in Latin America." In Mexican President Enrique Peña Nieto's words, "For Mexico, China means a prime

16. At the Seventh Pacific Alliance Summit held in Colombia in May 2013, the leaders of all four member countries expressed their support for the principles that underpin a free market economy and free trade.

opportunity to increase investment in production, build up export capability and diversify its export products".[17] There is still immense untapped potential for trade between China and the Pacific Alliance, especially in sectors such as agriculture, natural resources and tourism.

Members of the Pacific Alliance have increased their Chinese market for agricultural and manufacturing goods. Over the last decade Chile's exports of agricultural products and processed food items to China have increased dramatically, (in 2014, Chile was the second largest exporter of fresh fruit to China, and the second largest of wine). Colombia and Mexico also hold high expectations for the Chinese market to absorb their agricultural and processed products, and have been considering increasing the variety and scale of their agricultural exports to China. President Santos said, "Even if every Chinese person drinks only one cup of coffee every week, coffee growers in Colombia will find it difficult to cope with the demand." As economic growth accelerates, member countries find themselves in growing need for imports of technology and technical products. The relatively cheaper technology and technical products of China can not only help PA countries and other Latin American countries build up their manufacturing capabilities, but also to enhance their ability to export manufacturing products to China. There is vast scope for cooperation in the areas of manufacturing and technology sectors.

In terms of cross-border tourism, there are bright prospects for China-PA cooperation, and ample room for growth and the benefits that would accrue from tourism facilitation and a better tourism infrastructure. China has become a large exporter of overseas tourists and is poised to grow further. In 2014, outbound visits in mainland China reached 100 million (Xu Xiaolei, 2014). PA countries have abundant tourism resources and receive 3.5 million visits each year, of which only 1/350[18] come from China. China and PA countries should strengthen tourism infrastructure, such as mutual connectivity and airline alliance, and enhance international promotion and media reports of tourism resources of PA countries, so as to further develop the cross-border tourism industry.

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17. The remarks are from Peruvian and Mexican Presidents on April, 3, 2013 in an interview by Xinhua Press, prior to the state visit in China and the 2013 annual meeting in the Boao Forum for Asia.

18. "The Pacific Alliance Plans to Make China Its First Market for Tourism Promotion" Phoenix, http://fashion.ifeng.com/travel/world/detail_2014_08/08/37949903_0.shtml?69s--www.lsxfh.cn--yagsd.html, accessed on 8th August, 2014.

Energy and mineral products are important export sectors for the PA countries. The economic slowdown in China has weakened growth in its imports of mineral products from Latin America, but overall, Chinese demand is still huge. China's robust demand for energy and mineral products has also bolstered its wishes to invest in the energy and mineral sectors of PA countries. PA countries also hope to ramp up the development of their domestic energy and mineral industries and upgrade their industrial and technical capabilities by tapping into Chinese investments. The National Society of Mining and Petroleum of Peru (SNMPE) estimates that the four countries of the Pacific Alliance need a total of US$ 221 billion for their major mining investment projects. And it is projected that China will invest up to US$ 1.25 trillion abroad in the next decade.

As trade between China and member countries of the Pacific Alliance expands, the global industrial value chain is also changing. China has shown greater readiness to make both commercial and production investment in the mining, infrastructure, agricultural and manufacturing sectors in the PA countries. Infrastructure has a strong impact on the economic development of PA countries. Chile's high-grade highways and well-equipped ports have facilitated economic growth. There is vast potential for Chinese investment in infrastructure in Chile, Peru, and Mexico. PA countries have also drawn the attention of the Chinese investors to their agricultural and food processing sectors. The Chinese company Lenovo has reaped impressive returns from its investment in Chile's fruit production and wine making industry. Chinese companies have also invested in Mexico's car manufacturing sector.

VI. Advancing Trade and Economic Cooperation Through Cultural Exchanges and Talent Development

Trade expansion is always accompanied by increased cultural exchanges, and cultural differences can stand in the way of trade and economic cooperation. Tens of millions of cultural exchanges every year and hundreds of thousands of student exchanges for the last thirty years between China, Europe and North America have resulted in ever closer trade and economic ties. Similar exchanges between China and Latin America are lacking. Though business people and enterprises do cross the vast Pacific Ocean, they do not find it easy to cross cultural and language barriers. This has made it difficult for Chinese investors to find business partners in the host countries. Business

people who are capable of cross-cultural communication between China and Latin America are in such shortage that Chinese companies seeking investment opportunities in Latin America often have to consult tourist guides with no professional expertise.

From the perspective of multilateral cooperation, culture and education are also important dimensions of cooperation between China and the Pacific Alliance. Latin American countries have promoted the development of technological innovation and high-tech industry, but their efforts have been thwarted by the long-standing challenges of talent shortage and talent drain. The experience of North America, Europe and Australia shows that attracting Chinese students is an effective way to promote high-tech development. The PA countries and China should create a favorable environment for people-to-people exchanges and promoting cultural and student exchanges. Trade development is not just about selling goods. It must also focus on talent development and mutual understanding between different cultures. The PA countries should take full advantage of the 6,000 scholarships for overseas students from Latin American and Caribbean countries, and currently, some 6,000 training opportunities are provided by the Chinese government; at the same time, they should encourage more of their students to study in China. Meanwhile, the Pacific Alliance should also attract more Chinese students to study in PA countries, so as to better support and facilitate bilateral cultural exchanges.

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MARKET LIQUIDITY AND THE LATIN AMERICAN INTEGRATED MARKET (MILA)

Kassim J. Durrani and Jonathan Violante Pica

1. Introduction

The creation of the Integrated Latin American Market (*Mercado Integrado Latinamericano*, MILA) represents an important development in furthering the theme of 'open regional integration' in the Pacific coastal region of Latin America. The Pacific Alliance between Chile, Colombia, Mexico and Peru represents an economic region with a combined gross domestic product (GDP) of US $1.9 trillion, accounting for 35 per cent of Latin American GDP and 50 per cent of its international trade. In May of 2011, the stock markets of Chile, Colombia and Peru introduced an integrated trading platform allowing investors in each country to execute trades across all member countries. With the introduction of the Mexican stock exchange (*Bolsa Mexicana de Valores*) in December of 2014, MILA has now surpassed Brazil's BOVESPA as the largest exchange in Latin America, with a combined market capitalisation of US $839 billion and over 780 listed companies.[1]

Political leaders and proponents of MILA intend that the integrated exchange facilitate greater capital flows between member countries, attract greater foreign investment and encourage a greater number of initial public offerings (IPOs)[2] within member countries. At the heart of these intentions is the objective of enhancing market liquidity.[3] The impact of stock exchange

1. These figures according to the World Federation of Exchanges.

2. Brazil is the clear leader in the number and size of IPO's in the last decade, accounting for 56% of the region's IPOs having raised more than US $60 billion between 2002 and 2012. Mexico is a distant second with US $8 billion, followed by Chile (US $2 billion). Brazil had 143 IPOs over this same period, with Pacific Alliance member countries accounting for an aggregate total of 100 IPOs over this period (OECD, Bloom, 2013).

3. The IMF expects that the creation of MILA will increase market liquidity and the spectrum of investable assets (IMF, 2013, https://www.imf.org/external/pubs/ft/scr/2013/cr1345.pdf)

integration on liquidity is not well understood, and is to be the focus of this chapter. Stock markets play an integral part in long-term growth and economic development. They facilitate investment by reducing the cost of mobilising savings, and allow for innovation by allowing riskier and potentially productive smaller companies to attain financing. A liquid market is generally perceived as desirable due to improvements in capital allocation and informational efficiency. Higher liquidity increases investor participation and provides a more attractive market for IPOs.[4] The literature has found evidence of stock market consolidation having positive effects on market liquidity, but such benefits are not found to be equally distributed across firms.[5]

There are several reasons the market integration of MILA could result in increased market liquidity. Firstly, consolidation generally results in a broader market made up of a greater number of market participants. In other words, each firm has access to a larger number of potential investors. In the case of MILA, a listed firm in Peru now has access to a much broader investor base across the whole Pacific Alliance region. Secondly, the market is likely to deepen, with a larger number of potential orders available at prices marginally above and below the prevailing market price. Deeper markets limit the ability of large trades to drive price movements. Finally, the integrated trading system should allow for greater ease in transacting across exchanges, helping to reduce both information costs and the cost of trading.

In what follows, this chapter examines market liquidity in Chile, Colombia, Mexico and Peru during the integration of MILA. The chapter begins with a brief history of the rise of modern exchange consolidation, particularly that of Euronext. The chapter then examines the institutional arrangements of MILA. Then, the chapter focuses on an examination of market liquidity around the move to MILA using a dataset collected for all listed firms between 2001-2015. Finally, the chapter concludes with an assessment of the Peruvian advantage and Mexico's recent decision to join, and what this means for MILA and Latin America moving forward. Policy and economic recommendations are presented.

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4. Investors are more likely to participate in markets where liquidity is high, allowing them to buy and sell securities at lower cost. Parlour and Seppi (2003) show that market liquidity is a key variable for competition in order flow with other exchanges. Finally, Ellul and Pagano (2005) demonstrate that liquidity risk in the secondary market is a key determinant of the underpricing of initial public offerings (IPOs), so a liquid market is thought to be a key ingredient in attracting a greater number of IPOs.

5. Nielsson (2009) finds positive effects on the Euronext merger on market liquidity; however, liquidity gains are concentrated asymmetrically in firms of larger size and those with foreign sales.

2. The Rise of Stock Exchange Integration

Global stock exchanges have undergone significant change over the past decade with a number of private for-profit exchanges replacing once publically controlled national exchanges.[6] A global trend in favour of stock market integration has emerged. Exchange integration has been motivated by the need for improved competitiveness, the revolution in trading systems and information technology, and reductions in barriers to globalisation, deregulation and market liberalization.[7]

The most noteworthy stock market integration to date has been the NYSE-Euronext merger. In 2001, Euronext was formed when the Paris Bourse SBF SA, Brussels Stock Exchange, and the Amsterdam Stock Exchange merged, with further integration taking place to include the Lisbon Stock Exchange. In 2007, the New York Stock Exchange (NYSE) and Euronext merged to create the worlds largest and most liquid exchange group, NYSE-Euronext.[8] Other relevant stock exchange mergers include the OMX merger, the NASDAQ-OMX and the merger between the London Stock Exchange and Borsa Italiana.

Latin America is continuing the trend; these same motivations have driven the move to integrate exchanges under MILA, but with the added importance of attracting international visibility under the aim of open regionalism. Figure 1 shows that if taken together, the combined market of MILA is now the 18th largest exchange in the world, with a market capitalization of $839 billion.[9] MILA member countries have seen steady growth in the size of their equity markets over the past decade. Figure 2 shows that market capitalization of listed firms increased from 23% to 59% of GDP over this period.[10] This trend is in sharp contrast to the developed world, where OECD countries and the United States have experienced a marked decline.

6. The World Federation of Exchanges reports that in 1998, 38% of global exchanges were for-profit. In 2006 this figure had risen to 75% (see Nielsson, 2009).

7. See Figueroa (2014) and Dorodnykh (2014) for a more comprehensive summary of the incentives and determinants of stock exchange integration.

8. See press release. New York Stock Exchange (NYSE) April 5, 2007. "NYSE Euronext offers the most diverse array of financial products and services."

9. Data compiled from the World Federation of Exchanges (WFE). July, 2015.

10. Source of Data: World Bank (2014) World Development Indicators. http://http://data.worldbank.org/

FIGURE 1. Largest Stock Markets in the World
By Market Capitalization

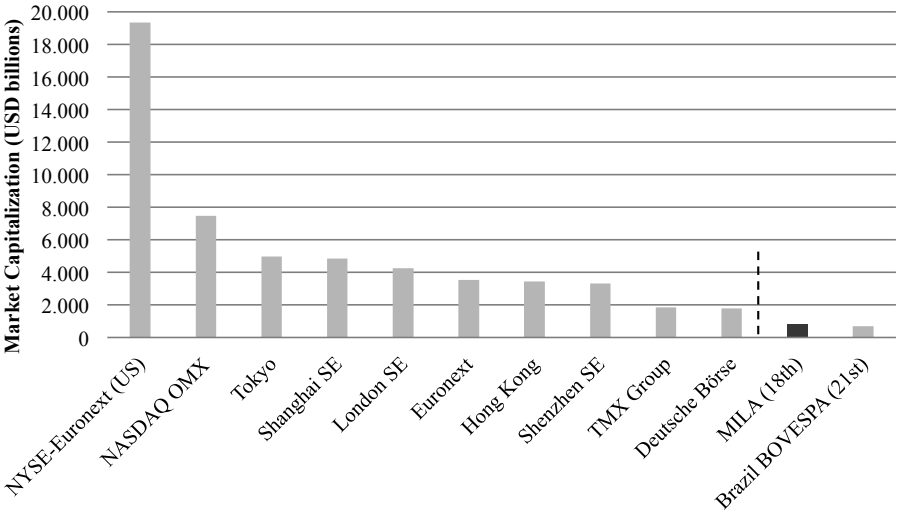
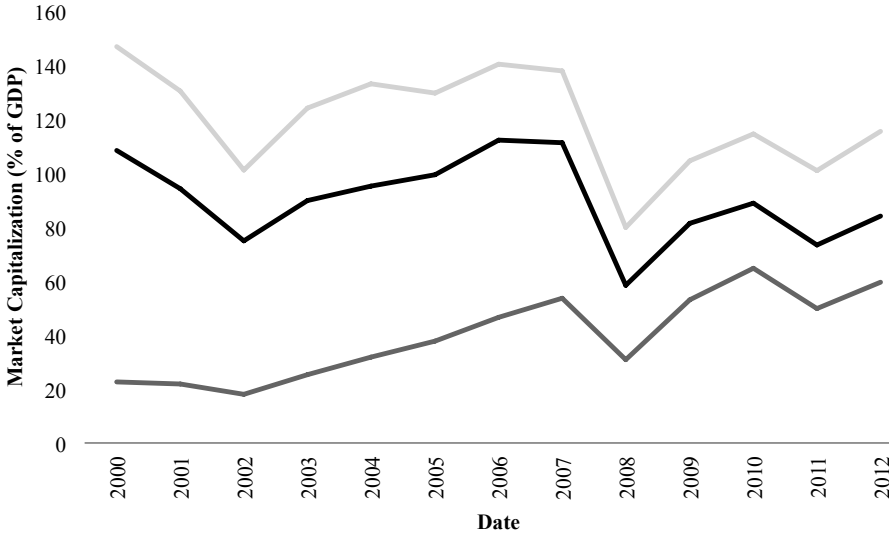


FIGURE 2. Market Capitalization of Listed Firms
MILA and the Developed World



3. The Institutional Arrangement of MILA

Background of MILA

The origin of MILA can be traced back to September of 2009 when a Letter of Intent was signed by the stock exchanges of Chile, Colombia and Peru.[11] A series of roundtable meetings were conducted for the creation and implementation of MILA from 2009. The first Memorandum of Understanding (MOU I) identified the aspects that were needed to be analysed prior to establishing an integrated stock market.[12] The second roundtable meeting was held in Lima on January 14-15, 2010. MOU II established the model of market integration.[13] Prior to the beginning of MILA's first stage, supervising entities conducted a third roundtable on June 21-22 of 2010. The potential benefits of MILA were discussed, and standards of implementation under local regulation were agreed upon. Finally, on May 30 of 2011, MILA commenced.[14] The Mexican Stock Exchange (*Bolsa Mexicana de Valores*) announced its first trade as part of MILA on 2 December, 2014.

Structure and Operation of MILA

MILA is a cross border trading platform operating using intermediary routing agreements ("IRAs") between brokers in member countries. IRAs are created in agreement with the laws of the country of destination; that is, the country where the broker desires to trade the security. In this way, the regulations and settlement procedures of the local country of origin apply to all transactions made on the integrated market.[15] Most importantly, MILA is not a stock market consolidation like NYSE-Euronext, authorities from the

11. For a more detailed summary of the origins of MILA and the local laws of each exchange and depository/regulatory agency see Figueroa (2014).

12. MOU I also established proper communication channels and a mechanism for guaranteeing confidentiality.

13. Under MOU II, stage one created a model of integration beginning in November 2010 without the need to modify local laws. In the second stage, member countries agreed to implement standard rules of negotiation by the end of 2011. Supervising entities established guidelines for implementation of MILA under MOU II.

14. Mercado Integrado Latinamericano, supra note 116.

15. See Figueroa (2014) for a great summary of the laws and procedures of MILA operation.

country of origin retain supervisory powers over issuers. However, a process of harmonisation of standards is continuing, with the potential for greater consolidation as a very real possibility.

Benefits and Challenges

The potential benefits of MILA are diverse. For investors, there are benefits associated with access to a much wider market. This allows for a higher level of risk diversification[16], a better risk-return balance and a single access point to foreign investors for gaining exposure to the attractive emerging markets of Latin America. For listed companies, there is now a greater market for equity funding. In addition, with four combined equity markets, there is a much greater primary equity market to attract new firms looking to list on the regional exchanges. For brokers and intermediaries, a more diverse range of financial products can be engineered for investors. Finally, MILA should benefit each country's stock exchange by attracting greater order flow and larger foreign investment, with the integrated market being more visible on an international scale.

While it is generally agreed upon that the move to MILA brings widespread potential benefits, the implementation has not come without its challenges. MILA is the first cross-country stock market integration without corporate integration.[17] Plans for further consolidation as a multi-jurisdictional exchange are in process.[18] The alignment of tax and legal systems across member countries has proved to be a challenging task. Peru's involvement was stalled when legislators resisted a reduction in capital gains tax to 5% to align with other member countries. A slow start, characterised by lower than expected trading volume in 2011, was attributed to concerns over emerging market equities and concerns over Peru's presidential elections. Concerns over dual currency conversion were also a challenge during MILA's inception

16. Traditionally, each market has individually been too small or risky for investors to look beyond the countries' dominant industries. MILA could allow investors to achieve greater diversification by combining Peruvian mining companies, Chilean retailers and Colombian construction firms.

17. Colombia and Peru have announced a corporate merger separate but complementary to MILA. Each member country maintains regulatory independence. Instead, a process of adaptation and standardization of regulations on trading in capital markets and the custody of securities is in effect.

18. Whilst such consolidation has been delayed, the integration of Chilean, Colombian and Peruvian stock exchanges has gathered pace over the past three years (Mendoza, 2015).

in 2011.[19] Further efforts to harmonize regulation and taxes will help drive down the costs associated with trading on MILA with greater potential for increasing exchange trading volume.

4. Market Liquidity and MILA

The remaining sections of this chapter will focus on the impact of exchange integration on the market liquidity of exchanges in Chile, Colombia, Mexico and Peru. The main motivation for this chapter's focus on market liquidity is that it ultimately influences firms' cost of capital. If we consider a security which has a low trading volume, it is generally harder to sell, and the bid-ask spread is generally higher, at a larger direct cost of trading. This makes the security less desirable, which is reflected in its liquidity premium (or in this case, a discount for illiquidity).[20] The literature documents a strong link between stock returns and the cost of capital[21]. It is thus no surprise that liquidity is the main concern of listed securities and the exchanges that serve them, and represents the main motivation for the study that is presented in what follows.

Literature and Hypotheses

The past literature is limited to the effect of market integration on individual firms. Few empirical studies have examined aggregate exchange liquidity outcomes following stock exchange integration. Existing studies have focused predominantly on the Euronext merger (Pagano and Padilla, 2005; Nielsson, 2009)[22]; this is the first study to examine market liquidity following the Latin American regional integration of MILA. Past studies have hypothesized that market liquidity should increase when stock markets merge for a number of reasons. Firstly, a broader market results in the fact that there are now more market participants now exist. Second, markets will deepen, since

19. Investors would first have to convert local currency into US dollars before again converting into the foreign exchange of the corresponding member country.

20. Amihud and Mendelson (1986) find that the most illiquid securities would gain 50% in value if liquidity gains were comparable to that of the most liquid securities.

21. Brennan and Subrahmanyam (1996), Datar, Naik and Radcliffe (1998) and Domowitz and Steil (2002).

22. These studies find that market liquidity did increase following Euronext stock market integration, with Nielsson (2009) finding an asymmetric effect for larger firms and firms with greater foreign sales.

there will be larger quantities available at prices around the prevailing bid and ask quotes. Third, greater economies of scale should reduce transaction costs and lower information costs. There is a competing hypothesis in the literature that favors lower market liquidity prevailing in response to a stock exchange merger. This argument predicts that monopolistic behaviour will occur as a result of concentration in one exchange. It is our view this is unlikely in the case of MILA, given the integration is not a consolidation of exchanges, but rather an integration of trading platforms. Despite past evidence of this hypothesis being much less compelling, it should be identified as a potential risk to further market consolidation under MILA.

Overall, the evidence of past literature seems to indicate that MILA exchanges should experience increased market liquidity following integration. However, the liquidity benefits may still be asymmetrically allocated between exchanges. A number of commentators have indicated that a 'Peruvian advantage' may exist.[23] Peru is expected to benefit the most in the long run, with its exchange being significantly smaller than Chile, Colombia and Mexico. Integrating into MILA allows Peru to have access to a significantly larger and more diverse exchange. The next section examines the data and provides a descriptive analysis.

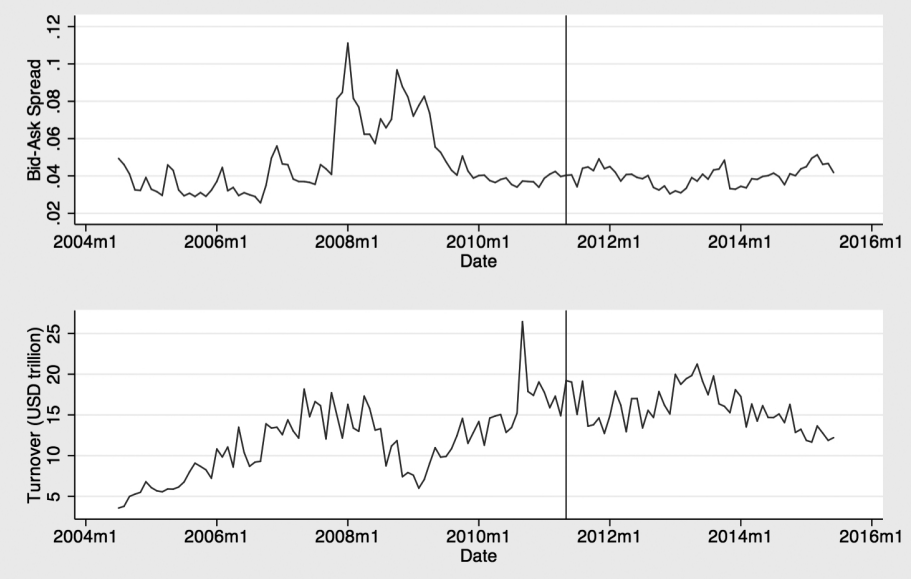
Data and Descriptive Analysis

The dataset is collected from Thomson Reuters Tick History and contains a total of 420 firms with daily observations over the period 1 July 2001 to June 30, 2015 (3609 periods) for a total dataset of 957,965 observations. We examine four liquidity measures across the aggregate MILA sample of listed companies, which include; bid-ask spread, turnover (USD), amivest ratio and return volatility.[24] Turnover captures the amount of trading that takes place between market investors. This chapter's focus is to determine whether market activity has increased as a result of the MILA integration of exchanges; thus, three other measures of liquidity are included. The bid-ask spread measures the cost dimension of trading in market securities. When the cost of trading is low, it is cheaper for investors to trade.

23. See http://www.oxfordbusinessgroup.com/analysis/regional-platform-three-countries-come-together-create-integrated-latin-american-market.

24. The appendix details how these four liquidity measures were calculated.

FIGURE 3. MILA Bid-Ask Spread and Turnover
July 2004 - July 2015



The amivest ratio measures the market depth dimension and the return volatility measures the variability in the daily stock price. Liquid markets are characterised by lower volatility in security prices on average, as well as having a higher market depth behind the best bid and ask quotes to reduce the price sensitivity of larger trades. Figures 3 and 4 shows the evolution of these measures over time, with the red line indicating MILA integration in May of 2011.

The figures provide a first indication that liquidity has increased across the sample. Whilst bid-ask spreads have, on average returned to pre-crisis levels since 2010, their variability has decreased when compared to the pre-crisis period. Monthly turnover (in USD trillions) exhibited an increasing trend leading up to the financial crisis of 2008. The financial crisis saw monthly MILA turnover fall from $17.3 trillion US in April of 2008, to $6 trillion US in February of 2009. An increasing trend has resumed since, but with a combination of lower confidence in emerging markets, and predictions that the US Federal Reserve bank will begin contractionary monetary policy in the near term, turnover has fallen back to a level of $12.2 trillion US for the month of June, 2015.

Figure 4 shows that the Amivest ratio, used to measure market depth, has exhibited a similar pattern to turnover; however, the ratio has stayed at a relatively high level in the post MILA period. This is an indication that whilst emerging markets such as Latin America have suffered capital outflows in recent times, the MILA stock markets have retained considerable market depth. Finally, Figure 4 presents aggregated daily returns for the MILA markets. The figure indicates that variability of returns has visibly decreased. Market returns fell from 3.93% in the pre MILA period to 3.09% in the post MILA period, characterising a more liquid market.

FIGURE 4. MILA Amivest and Market Return
July 2004 - July 2015

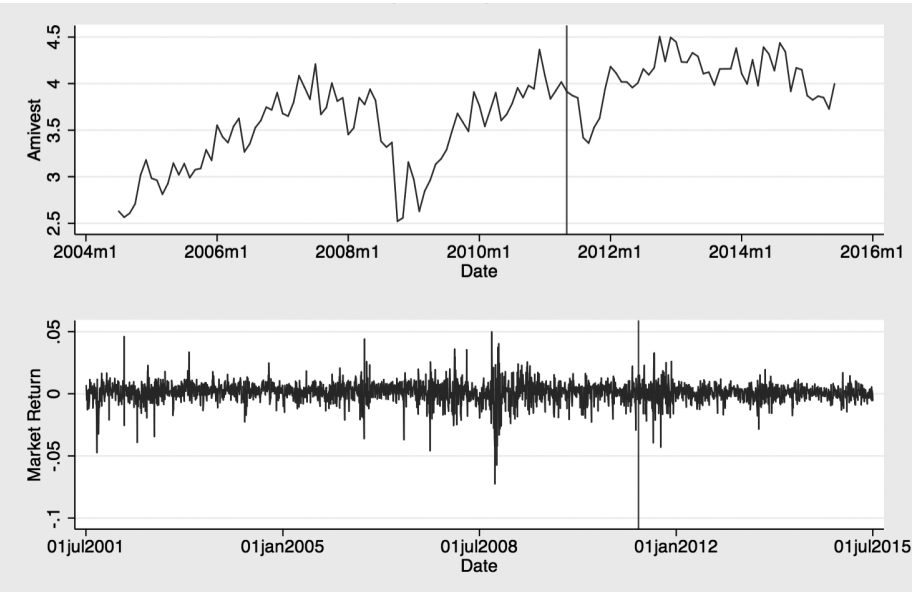


TABLE 1. Descriptive statistics for sample observations

This table reports summary statistics the pre (panel A) and post (panel B) MILA samples. Turnover is reported in USD billions. Amivest ratio measures the market depth calculated as the daily turnover divided by the change in price, returns are measured in daily terms, Assets are measures in USD billions. Standard deviation for each measure is presented in parentheses. Data sourced from Thomson Reuters Tick History.

Panel A: Pre-MILA	Chile	Colombia	Mexico	Peru	Total
Number of Firms	201	53	85	81	420
Percentage of MILA firms (%)	47.86	12.62	20.24	19.29	
Daily Turnover (USD bil)	1.1425	1.363	5.58	0.313	2.135
	(6.861)	(15.685)	(15.676)	(2.805)	(10.897)
Amivest	3.3050	2.298	4.796	1.723	3.215
	(2.174)	(3.526)	(1.964)	(1.787)	(2.500)
Bid-ask spread	0.0724	-	0.025	0.055	0.051
	(0.142)	-	(0.077)	(0.105)	(0.113)
Returns	0.0016	0.002	0.0007	0.002	0.0015
	(0.034)	(0.034)	(0.031)	(0.049)	(0.037)
Assets	1206.1940	10547.4	64.269	3.73	1269.17
	(3066.68)	(15899.38)	(108.664)	(8.075)	(5125.32)
Panel B: Post-MILA	**Chile**	**Colombia**	**Mexico**	**Peru**	**Total**
Number of Firms	185	59	65	74	383
Percentage of MILA firms (%)	48.30	15.40	16.97	19.32	
Turnover	1.724	2.239	9.31	0.381	3.353
	(8.823)	(5.998)	(20.928)	(2.657)	(12.419)
Amivest	3.852	4.611	5.683	2.276	4.066
	(2.186)	(1.865)	(1.833)	(1.952)	(2.320)
Bid-ask spread	0.052	-	0.008	0.05	0.040
	(0.118)	-	(0.026)	(0.076)	(0.096)
Returns	0.0003	0.0003	0.0003	0.0002	0.0003
	(0.029)	(0.038)	(0.025)	(0.029)	(0.030)
Assets	1704.43	17955.9	121.216	8.773	3098.54
	(4934.59)	(31141.27)	(220.561)	(20.476)	(12754.93)

Examining the summary statistics presented in Table 1 provides us with our first indication that liquidity has increased across the MILA country stock markets in the post integration period. In each of the four countries, average firm turnover and Amivest ratio has increased. Bid-ask spreads decreased in the post MILA period for all countries and the standard deviation of returns decreased in each country with the exception of a slight increase for Colombia.

Methodology

To analyse the impact of MILA integration on stock market liquidity we employ a fixed-effects panel regression with dummy variables capturing key event date.[25] The following model is used:

$$L_{it} = \alpha + \beta MILA_{it}^{events} + \gamma X_{it} + \pi D_t^{month} + v_i + \varepsilon_{it}$$

where the subscripts refer to the firm *i* and time *t*. The dependent variable is the outcome variable of interest ; it is measured by three different variables (bid-ask spread, amivest and turnover). The two MILA integration dates are included as dummy variables. The first is the initial integration of the stock markets of Chile, Colombia and Peru in May of 2011. The second is the further integration of the Mexican stock market into MILA in December of 2014. These variables take a value of 0 prior to integration and 1 after integration. This model specification allows coefficient estimates of the MILA dummy variables to isolate the effect on integration on stock market liquidity. To control for any unrelated impacts on market liquidity, two control variables are included in the dependent variable . The two variables SP500 Variability and Brazil Variability are the 20-day historical rolling standard deviation of daily returns on the SP500 index and the BOVESPA index respectively. The variable aim to control for any changes in market liquidity that cannot attributed to the integration of MILA. The model also includes monthly dummy variables to control for all events that are unrelated to the MILA integration. The monthly dummies can be thought of a as a time trend (a monthly fixed effect). These dummy variables filter out the average monthly change in liquidity across all firms on the four exchanges, leaving us with the variation attributable to the move to integrate under MILA.

25. This model is similar to that used in past studies such as Pagano and Padilla (2005) and Nielsson (2009).

Empirical Results

1. Aggregate MILA Results

The first set of empirical results are presented in Table 2 examining the impact of MILA integration on our three measures of market liquidity. The models presented are fixed-effects regressions with 420 firms across the sample period July 2001 to June 2015. Columns (1) and (2) report the results of the impact of MILA market integration on bid-ask spread. The coefficient estimate for the variable *MILA 1* is negative and significant, indicating that the initial integration of trading systems between Chile, Colombia and Peru in May of 2011 had the effect of reducing the cost dimension of trading. The magnitude of this cost saving is quite considerable at -3.15%, considering the average bid-ask spread over the entire sample period is 4.63%. Results presented in columns (3) and (4) indicate that turnover has increased significantly in response to the MILA integration. For the purpose of a better model specification, the natural logarithm of turnover is used with a coefficient in USD billions. The coefficient of 1.76 is of a significant magnitude given the average sample turnover (in log US billions) is 16.21. This result indicates that the initial market integration of MILA resulted in a higher level of trading volume. Finally, columns (5) and (6) examine the impact of MILA integration on the amivest ratio. Coefficient estimates are positive and significant, indicating that stock market depth has increased as a result of the initial move to MILA in May of 2011.

The empirical results presented in Table 2 confirm that market liquidity has increased as a result of the initial integration of trading platforms between Chile, Colombia and Peru. The addition of Mexico to MILA in December of 2014 had no impact on market liquidity, with findings reporting an insignificant coefficient estimate for the variable *MILA 2* across all models. An argument can be made that the liquidity benefits of Mexico joining MILA were perhaps already being factored in by market participants, given the *Bolsa Mexicana de Valores* had already confirmed its intention to join at the inception of MILA.

The control variables, *SP500 Variability* and *Brazil Variability* were included in the model with the purpose of removing any global liquidity variance that was not specifically attributed to the MILA stock markets. *SP500 Variability* is positive and significant in column (1) indicating that greater variability in the US stock market returns resulted in larger bid-ask spreads

for firms in MILA country stock markets. There was no effect on turnover or amivest, with reported coefficients being insignificantly different from zero. *Brazil Variability* is positive and significant in column (2) indicating that, similar to the US stock market, an increase in the variability of Brazilian stock market returns resulted in a corresponding increase in the bid-ask spread for firms in MILA stock markets. Interestingly, greater variability in Brazilian firm returns resulted in greater turnover in MILA stock markets. This result provides some indication that when risk increases in Brazilian stocks, market participants decide to invest to a greater extent in the neighbouring Latin American stock markets of the MILA countries. There was no relationship with amivest, with the coefficient for *Brazil Variability* being insignificantly different from zero.

It must be noted that the adjusted r-squared, a measure of the goodness of fit of the models presented in Table 2 are relatively low, with magnitudes between 0.03 and 0.20.

2. Country-Specific Results

The next series of models examine the country specific impact of MILA integration on market liquidity. The results are presented in Table 3 for each of our three liquidity measures; bid-ask spread, turnover and amivest. Panel A examines bid-ask spread across the MILA countries; however, due to data constraints, Colombia was not able to be included. The coefficient for the integration dummy variable *MILA 1* is negative and significant for both Chile and Mexico. The magnitudes of the coefficients are considerable for both countries, -0.022 and -0.045 for average sample bid-ask spreads of 0.063 and 0.020, respectively. Results indicate that the cost of trading for market participants decreased significantly for Chile and Mexico, but not for Peru. Examining the control variables SP500 Variability and Brazil Variability, results are in line with expectations that greater variability in prices for US and Brazilian exchanges had a positive influence on the cost of trading in MILA exchanges.

TABLE 2. The effect of integration on liquidity in MILA country stock markets overall

*This table examines the effects of integration on market liquidity in the stock markets of Chile, Colombia, Mexico and Peru. The sample period covers July 2001 to June 2015. Colombia is excluded from models 1-3 due to a lack of data on bid-ask spread over the per-MILA period. Bid-Ask Spread is the end of day average spread between the best bid and ask quotes at the security level. Turnover is the natural logarithm of daily security turnover. Amivest is the daily dollar volume of the security divided by its daily change in stock price. MILA 1 is a zero/one dummy variable reflecting the initial integration of the markets of Chile, Colombia and Peru in May 2011. MILA 2 is a zero/one dummy variable reflecting the inclusion of Mexico as part of MILA in December 2014. SP500 Variability is the 20-day historical rolling standard deviation of returns of the SP500 index. Brazil Variability is the 20-day historical rolling standard deviation of returns of the BVSP index. Robust t-statistics in parentheses are based on standard errors clustered at the monthly level. ** indicates significance at the 5% level. Data sourced from Thomson Reuters Tick History.*

	MILA											
Independent variables	Bid-Ask Spread		Bid-Ask Spread		Turnover		Turnover		Amivest		Amivest	
MILA 1	-0.032	**	-0.031	**	1.76	**	1.76	**	2.01	**	2.01	**
	(-3.55)		(-3.52)		(7.52)		(7.54)		(10.61)		(10.60)	
MILA 2	-0.0029		-0.00055		0.11		0.11		0.018		0.017	
	(-0.33)		(-0.06)		(0.98)		(1.01)		(0.98)		(0.92)	
SP500 Variability	0.37	**			0.13				-0.23			
	(4.37)				(0.12)				(-0.90)			
Brazil Variability			0.33	**			1.6	**			0.066	
			(6.21)				(2.14)				(0.31)	
Constant	0.078	**	0.077	**	14.5	**	14.5	**	1.92	**	1.91	**
	(9.96)		(9.75)		(87.62)		(87.32)		(13.57)		(13.47)	
Security Intercepts	Y		Y		Y		Y		Y		Y	
Monthly Intercepts	Y		Y		Y		Y		Y		Y	
N	599829		599829		734646		734646		767359		767359	
adj R-sq	0.03		0.03		0.10		0.10		0.20		0.20	

The results presented in Panel B show that under the MILA integration, trading volume increased substantially. When taken in log USD billions, turnover increased by 1.58, 6.05, 1.87 across Chile, Colombia and Mexico respectively. The exception is Peru, where daily stock market turnover decreased by 1.16 in log billion terms. The inclusion of Mexico into MILA in December of 2014 resulted in reduction in turnover in Colombia, and an increase in market turnover in Peru, as captured by the model coefficients of *MILA 2*, with Chile and Mexico having no significant impact. The control variable SP500 Variability was negative and significant across Chile, Colombia and Mexico. This result provides an indication that greater risk in global markets resulted in less trading in the emerging markets of Latin America. Greater variability in the Brazilian market has a positive influence on turnover in the Mexican market. This results could signify a capital flight from the largest exchange in Latin America, the *BOVESPA* of Brazil, to the second largest exchange, the *Bolsa Mexicana de Valores,* as investors seek to obtain access to less risky exposures in the emerging Latin America region.

Finally, panel C presents results for the liquidity variable Amivest, used to measure any changes in market depth as a result of the MILA stock market integration. Again, the stock market of Peru is the exception, with market depth increasing significantly across Chile, Colombia and Mexico as a result of the initial move to MILA, but with no significant effect in the Peruvian stock exchange. Coefficients for *MILA 1* are positive and significant across Chile, Colombia and Mexico, with magnitudes of 1.89, 5.31 and 1.74 respectively. There is no impact found for the move by Mexico to join MILA, with the coefficients for *MILA* 2 all being insignificantly different from zero. Variability in the US and Brazilian stock markets reduces market depths in the Chilean exchange, with no effect on the other exchanges of MILA.

TABLE 3. The effect of integration on liquidity in individual country stock markets overall

*This table examines the effects of integration on market liquidity in the stock markets of Chile, Colombia, Mexico and Peru. The sample period covers July 2001 to June 2015. Colombia is excluded from bid-ask spread models due to a lack of data. Bid-Ask Spread is the end of day average spread between the best bid and ask quotes at the security level. Turnover is the natural logarithm of daily security turnover. Amivest is the daily dollar volume of the security divided by its daily change in stock price. MILA 1 is a zero/one dummy variable reflecting the initial integration of the markets of Chile, Colombia and Peru in May 2011. MILA 2 is a zero/one dummy variable reflecting the inclusion of Mexico as part of MILA in December 2014. SP500 Variability is the 20-day rolling historical standard deviation of returns of the SP500 index. Brazil Variability is the 20-day rolling historical standard deviation of returns of the BVSP index. Robust t-statistics in parentheses are based on standard errors clustered at the monthly level. ** indicates significance at the 5% level. Data sourced from Thomson Reuters Tick History.*

	Bid-Ask Spread											
Independent variables	Chile		Chile		Mexico		Mexico		Peru		Peru	
MILA 1	-0.022	**	-0.022	**	-0.045	**	-0.045	**	0.0089		0.010	
	(-4.57)		(-4.70)		(-3.43)		(-3.40)		(0.74)		(0.86)	
MILA 2	-0.0062		-0.0026		0.00086		0.0019	**	0.0029		0.0039	
	(-0.39)		(-0.16)		(0.83)		(2.20)		(0.47)		(0.65)	
SP 500 Variability	0.59	**			0.16				0.13			
	(4.53)				(1.79)				(0.67)			
Brazil Variability			0.54	**			0.14	**			0.19	**
			(5.85)				(2.06)				(2.43)	
Constant	0.093	**	0.091	**	0.049	**	0.048	**	0.076	**	0.074	**
	(30.36)		(29.70)		(4.75)		(4.62)		(8.93)		(8.76)	
Security Intercepts	Y		Y		Y		Y		Y		Y	
Monthly Intercepts	Y		Y		Y		Y		Y		Y	
N	248151		248151		187738		187738		163940		163940	
adj R-sq	0.04		0.04		0.05		0.05		0.05		0.05	

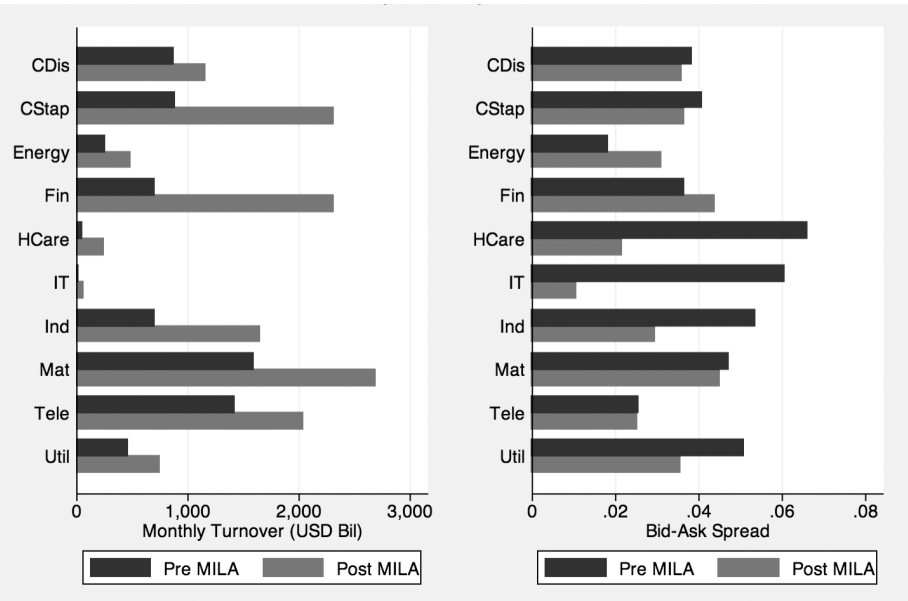
	Turnover															
Independent variables	Chile		Chile		Colombia		Colombia		Mexico		Mexico		Peru		Peru	
MILA 1	1.56	**	1.59	**	6.03	**	6.07	**	1.87	**	1.88	**	-1.16	**	-1.17	**
	(6.18)		(6.26)		(5.19)		(5.22)		(5.24)		(5.29)		(-2.63)		(-2.67)	
MILA 2	0.26		0.24		-0.32	**	-0.36	**	-0.25		-0.18		0.62	**	0.63	**
	(1.33)		(1.21)		(-2.27)		(-2.60)		(-1.48)		(-1.07)		(2.15)		(2.18)	
SP 500 Variability	-4.49	**			-6.19	**			11.2	**			1.54			
	(-2.62)				(-2.03)				(7.07)				(0.64)			
Brazil Variability			-0.64				-4.26				8.47	**			0.71	
			(-0.57)				(-1.93)				(8.29)				(0.43)	
Constant	16.3	**	16.2	**	13.9	**	13.9	**	14.7	**	14.7	**	10.6	**	10.6	**
	(94.14)		(93.27)		(15.13)		(15.10)		(59.99)		(60.81)		(51.83)		(51.95)	
Security Intercepts	Y		Y		Y		Y		Y		Y		Y		Y	
Monthly Intercepts	Y		Y		Y		Y		Y		Y		Y		Y	
N	302812		302812		104153		104153		182357		182357		145324		145324	
adj R-sq	0.08		0.08		0.27		0.27		0.15		0.15		0.12		0.12	

Independent variables	Chile		Chile		Colombia		Colombia		Mexico		Mexico		Peru		Peru	
MILA 1	1.89	**	1.89	**	5.3	**	5.31	**	1.74	**	1.73	**	-0.9		-0.9	
	(9.04)		(9.05)		(5.04)		(5.04)		(5.23)		(5.22)		(-1.83)		(-1.83)	
MILA 2	0.031		0.025		-0.0023		-0.0039		-0.0032		-0.00092		0.032		0.032	
	(0.95)		(0.75)		(-0.34)		(-0.97)		(-0.24)		(-0.07)		(0.44)		(0.44)	
SP 500 Variability	-1.04	**			-0.45				0.51				-0.052			
	(-2.58)				(-0.46)				(1.86)				(-0.15)			
Brazil Variability			-0.77	**			0.30				-0.11				0.21	
			(-2.47)				(0.38)				(-0.35)				(0.90)	
Constant	1.95	**	1.95	**	-1.18		-1.19		3.86	**	3.87	**	0.86	**	0.85	**
	(11.74)		(11.73)		(-1.30)		(-1.32)		(18.16)		(18.23)		(3.11)		(3.10)	
Security Intercepts	Y		Y		Y		Y		Y		Y		Y		Y	
Monthly Intercepts	Y		Y		Y		Y		Y		Y		Y		Y	
N	313308		313308		98120		98120		188314		188314		167617		167617	
adj R-sq	0.18		0.18		0.44		0.44		0.28		0.28		0.22		0.22	

3. Industry Analysis

This section examines the effect of MILA integration on the market liquidity of firms across the industrial sector. Figure 5 shows average turnover and bid-ask spread across the 10 major GIC standardized industry codes. Monthly turnover increased across all industries, with the largest increases coming from firms operating in the consumer staples and financials industries. In regards to the bid-ask spread, all industries benefited from a reduction in the cost of trading with lower average bid-ask spreads, with the exception of the financials and energy industries. The largest reductions in average bid-ask spread were found for firms operating in healthcare, industry and IT industries.

FIGURA 5. MILA Industry Analysis
July 2001 - July 2015

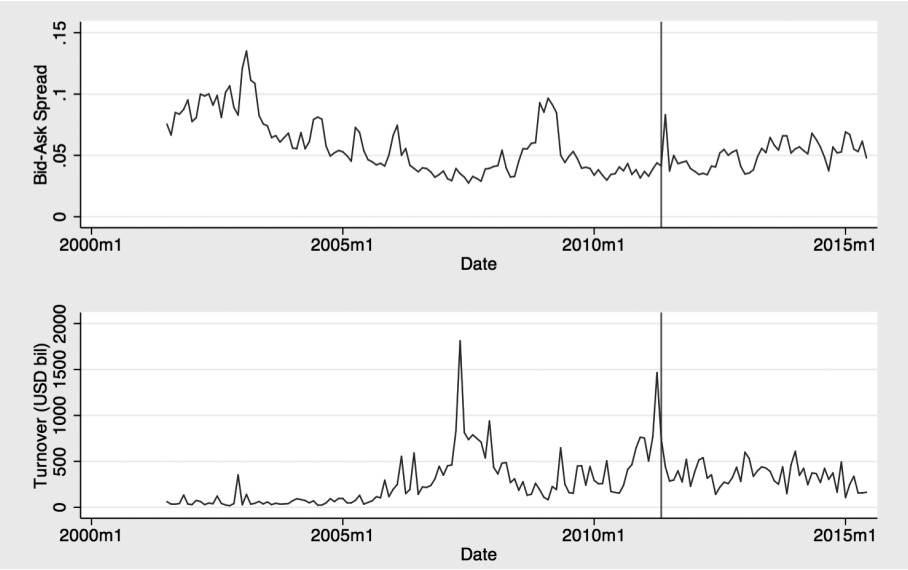


6. THE PERUVIAN ADVANTAGE

Despite initial challenges faced by the integration under MILA, Peru is thought to benefit the most in the long run. As with free-trade agreements, the

smaller party tends to accrue the greatest benefits. Prior to integration under MILA, investments in the Peruvian stock exchange would often be quite illiquid, so much so that the investors would worry about being able to unwind stock positions in a timely manner.[26] MILA was thought to solve this problem, allowing investors a more diverse and highly liquid market across the integrated trading platform. However, the empirical results of this chapter find that such liquidity benefits have not yet materialised. Turnover and Amivest both decreased significantly in Peru after the initial MILA integration, as shown in Table 3. The election of President Humala may have been a determining factor in this result. It coincided with the integration to MILA during the second half of 2011. Markets reacted to the election with a 12.5% fall the following day, with mining firms losing 15%. Market commentators attributed the fall to fears that the left-wing president would increase state control and ruin fiscal discipline.[27]

FIGURA 6. Peru. IGRA Index
July 2001 - July 2015

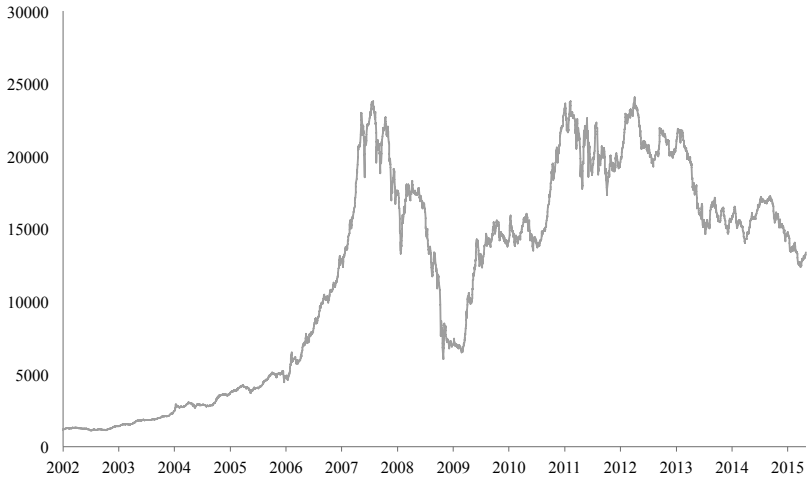


26. See http://www.oxfordbusinessgroup.com/analysis/regional-platform-three-countries-come-together-create-integrated-latin-american-market.

27. See http://www.reuters.com/article/2011/06/07/us-peru-election-idUSTRE75432720110607

In the post-MILA period, the average bid-ask spread for Peruvian firms has remained elevated, and turnover has taken on a volatile and slightly decreasing pattern. In the four years leading up to MILA between 2007 and 2011, the average Peruvian firm had a bid-ask spread of 0.045. This increased to 0.049 in the post-MILA period. Similarly, turnover decreased from 0.41 to 0.38 (USD billions) over the same period of time. Since becoming one of the worlds fastest growing economies, Peru has since failed to attain the same levels of growth. As sh´own in Figure 7, the Peruvian .IGRA Index has fallen sharply since its peak in 2012. However, there are some mixed indications, with daily return volatility being significantly lower in the post-MILA period, a sign of a more liquid and developed market.

Figura 7. Peru. IGRA Index



Conclusion

This chapter confirms that the integration of MILA resulted in an increase to market liquidity in the Pacific Alliance overall. However, results demonstrate that the increase in market liquidity is not homogenously distributed. Whilst the stock exchanges of Chile, Mexico and Peru benefited significantly greater

turnover, market depth and reduced trading costs, in Peru results were not as beneficial. Market liquidity actually declined in the post MILA period. These effects are more likely to be temporary, a result of a combination of structural changes to align with the tax and legal systems of other more developed member countries, and foreign investors fears that the newly elected president may restrict the overall development of the economic and financial sector.

A large-scale liquid equity market is integral to long-term growth. It reduces information costs and facilitates investment by reducing the cost of mobilising savings. In addition, it allows for innovation, since risky and potentially productive companies are better able to find financing. It is our view that the integration of trading systems under MILA provides a first step towards achieving these benefits. The study presented in this chapter proves that overall, the Pacific Alliance region is already benefiting from a greater scale and higher level of market liquidity. However, if its full benefits are to be realised, a full consolidation of exchanges is recommended. Integrating the operations of the exchanges would eliminate duplication of their fixed costs, and therefore reduce the average cost of a trade for the exchange. In addition, efficiencies in the clearing and settlement mechanism can be achieved by a full merger between the Pacific Alliance country exchanges.

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Appendix

The Amivest ratio is a liquidity measure that indicates the level of market depth. It provides an indication of the impact trading has on market price. The identifies just how much can be traded in a liquid stock without any significant changes in the stock price. The Amivest ratio therefore captures the amount of trading volume associated with a unit change in the stock price. It is defined as follows:

$$\text{Amivest}_i = \frac{\sum_{t=1}^{T} V_{i,t}}{\sum_{t=1}^{T} |R_{i,t}|}$$

where and are the trading volume and absolute return, respectively, for stock i on day t (with T being the number of trading days in the month in the case of monthly Amivest). A high Amivest ratio therefore corresponds to investors being able to trade a large number of shares without significant changes in price.

The bid-ask spread indicates the cost-dimension of liquidity. It is defined as the percentage of the mid-quote as follows:

$$\text{Spread}_i = \frac{P_A - P_B}{((P_A + P_B)/2)}$$

where and are the quoted ask and bid prices, respectively.

CONCLUSIONS

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The Pacific Alliance represents a prominent initiative in establishing an open regional integration amongst the member countries of Chile, Colombia, Mexico and Peru. In the four years since its inception, the Pacific Alliance has made significant progress in both unilateral and regional economic reform with the goal of supporting inclusive and sustainable economic growth. Progress has already included an agreement to eliminate 92% of tariffs on intra-trade goods, with the remaining being phased out in the short to medium term.

The establishment of the Integrated Latin American Market (MILA) has aimed at promoting growth in the trading activity of member countries, providing a more liquid, efficient and competitive infrastructure, promoting greater opportunities for local and foreign investors. The strengthening regional economic framework is well placed to benefit from increasing ties with Asia-Pacific markets. Progress has also been made in regards to the mobility of human resources, with the introduction of a visa waiver program among member countries.

The Pacific Alliance's emphasis has been on increasing ties with the fast-growing Asia-Pacific region. Already, a large number of nations from this region have elected to gain observer status, including China, Japan, Australia, New Zealand and Indonesia. Bilateral trade and mutual investment between Pacific Alliance members and Asia-Pacific countries is a crucial part of economic cooperation and an important channel for global value chain-oriented transnational industrial integration.

With China settling into a slower rate of economic growth, there is a need to restructure its huge international reserve assets, optimize the global allocation of these assets and to encourage overseas investment. China's domestic consumption capacity will increase dramatically, whilst demand for imports will also grow. A readjustment and relocation of China's factor-intensive

industries is unavoidable. These changes will have significant effects on the cross-border linkages between China and the Pacific Alliance Member Countries. Trade between China and Latin America has been growing significantly for the past decade, but there is still immense potential for trade in sectors such as agriculture, natural resources and tourism. China has shown a willingness to make commercial and production investments in mining, infrastructure, agriculture and manufacturing sectors in the PA countries. Overall, whilst challenges remain, China and other Asia-Pacific countries present significant opportunities to PA countries for considerable growth in bilateral trade and mutual investment moving forward. It remains to be defined which areas will be fruitful for a convergence of regional cooperation. In any case, the most important point is the keen interest of the Pacific Alliance in fully understanding the experiences of the Asia-Pacific region, and setting up a forum for dialogue and inter-regional political convergence.

The development of the Latin America Integrated Market (MILA) is intended to facilitate greater capital flows, attract greater foreign investment and encourage a greater number of IPOs within Member Countries. Since its inception, market liquidity has grown in the stock markets of all member countries. Such an outcome is a positive sign: stock markets have been shown to play an integral part in long-term growth and economic development through the facilitation of investment. Higher market liquidity increases investor participation and provides a more attractive market for IPOs.

While it is true that the PA Members alone account for more than half of Latin America and the Caribbean's total merchandise exports, they also present one of the lowest levels of intra-regional trade among all Latin American economic integration groups. Regardless of having relatively low levels of internal trade between Member Countries, the Pacific Alliance has achieved highly successful international projection. Such international attention is a product of unilateral progress; in fact, each of the member countries making up the Pacific Alliance have been regarded as some of the most innovative and best economies for conducting business within the region.[1]

Nevertheless, in order to become a relevant player in a global landscape and incorporate a key global trade platform, further integration is necessary. A key aspect to such integration is the free flow of human capital and the homologation of academic qualifications. Great efforts have been made in

1. Global Innovation Index (2015) and The World Bank Group, Doing Business Report (2016).

order to promote both; however, time and quantity restrictions for the free movement of people impose a challenge for PA students, academics, entrepreneurs and businesses alike. A higher level of integration would be beneficial for all members: it would promote the creation of economies of scale, enable an improvement in resource allocation, and most specifically, it would allow for much-needed skills transfers and an equally necessary consolidation of global value chains. All of these factors would enable the widening of the PA's export basket, particularly Chile, Colombia and Peru, whose export basket is currently dominated by raw materials.

The four countries comprising the Pacific Alliance have immense potential which has yet to be revealed from the standpoint of technological and skills transfers. Sharing a common language represents a great opportunity, particularly within the service industry. Allowing free movement of people accelerates the establishment of technology clusters in different regions and sectors yet to be exploited in the Latin American economies. For this however, there is a need to remove both time and visa restrictions which continue to exist under the free movement framework currently in place. Although the first implementation for free movement was a step in the right direction, further progress is needed to have a material impact on growth and innovation within the region.

A substantial consolidation of global value chains would increase trade of intermediate goods significantly within the member countries. Currently, as shown in earlier chapters, such levels are comparably quite low, mainly comprising the export of parts and components, accounting for only 7% of inter-PA trade. Deepening the trade of parts and components will only be possible through the consolidation of global value chains. Interregional trade of exports in Latin American and the Caribbean comprise less than half of that of more consolidated regional agreements such as those in North America, East and Southeast Asia and Europe. In this context, policy makers of the Pacific Alliance must provide a mechanism for *translatinas*[2] and SMEs to approach the region as one individual consolidated economic ground for opportunities, where operations –technical, mechanical and technological–, services, capital, knowledge, innovative skills and human resources can move smoothly from one country to another with no other impediments beyond the physical distance between PA member countries. The smoothening of operational movements also allows companies access to a much larger market at inception,

2. Multinationals originating within the PA.

where companies would ideally launch products and services to the Pacific Alliance as a single market. If implemented effectively, this would have a tremendous impact on SME opportunity and development – which together make up close to 99% of companies in the Pacific Alliance.

Institutionalization of the Pacific Alliance

Since the Pacific Alliance is not permeated by geography but rather by a shared vision of economic policy, a strategy that has so far proven very successful, it will need to evolve through institutionalization in order to maintain its momentum and respond to the high global expectations.

A Permanent Secretariat of the Pacific Alliance is necessary in order to deepen and enrich the alliance's working agenda, which would in turn, offer a substantial framework to do business with Latin America. Previous attempts at integration in Latin American may have hampered the will for further integration under the PA, as potential inconsistencies have proven challenging within the region. Nevertheless, there are areas where further integration would impose little political disagreement whilst greatly promoting economic activity and innovation.

The establishment of a Pacific Alliance Statistical System is necessary, similar to that of the European Statistical System, collaborating with member country's own statistical agencies in order to coordinate inquiries in important areas where statistical information is mostly lacking. Examples of such include; statistical linkages of the origin of FDI inflows with destinations for each economic sector, official statistics on trade in services by partner country, comparable statistics among members on trade in services by partner, total sales of services made by members locally established affiliates, subsidiaries or representatives of foreign owned and controlled companies. Having these types of statistics would enable the development of strategies to promote intra-regional trade between members and would allow an agenda to be formulated for the joint promotion of business across member countries.

A second institution that is highly needed within the Pacific Alliance is a body in charge of the homologation of academic studies. This is not to say that such institution would have the faculty to implement a PA-wide recognition of academic diplomas, but rather a central body that can coordinate with each of the countries authorities. The central institution would allow for easy access to all necessary information and facilitate the process of human resource

movement across the PA. Such an initiative would have to be implemented together with aforementioned removal of time and visa number restrictions. Free movement of people is critical to the realization of the PA strategy and to sustained economic development as a region. MILA is a very important step towards further integration, but in order to reach its full potential, the Pacific Alliance needs further actions.

A more institutionalized Pacific Alliance would also be highly beneficial for its members when it comes to mega-regional trade negotiations such as the Trans Pacific Partnership (TPP). Currently the only three Latin American members in the TPP negotiations are also members of the Pacific Alliance. This fact would undoubtedly allow the three countries to hold a stronger shared position in negotiations surrounding the TPP. Given the fact that shared economic interests brought the member countries together, those same shared economic interests could promote the priorities of the Pacific Alliance, and to some extent, those of the Latin America region within the TPP. Having a greater say in mega-regional negotiations is very important, as this new trade pattern will most likely have a huge impact on the direction of Latin American investment flows. However, challenging, continued socioeconomic convergence is needed, specifically in areas such as gender equality, climate change, labor and cultural exchanges.

The Need for Better Infrastructure

With 90% of world trade carried out by sea, the Pacific Alliance needs better port infrastructure in order to achieve its goal of gaining greater inclusion in trade linkages and global value chains (Kaluza, Kölzch *et al*, 2010). The Ministers of Finance of the Pacific Alliance have expressed their awareness of the importance of having better infrastructure within the region. Joint actions to fund much-needed infrastructure would make it easier for member countries to find investment. The issuance of Pacific Alliance Bonds could fund the construction of ports, bridges and highways with the commitment of the four governments, paving a smoother transition for development of infrastructure. The current slowdown in some of the BRICS countries presents an important opportunity for the Pacific Alliance to attract FDI with emerging market interest.

Beyond Asia Pacific

It is interesting to note that despite the Asia-Pacific being the main focus of the PA, inter-regional political dialogue has transcended the target area initially proposed by the founders. The interest of countries from all around the world in the Pacific Alliance has been unprecedented. This is most clearly shown by the sheer amount of countries acting as observers to the PA. Currently, there are 42 countries with observer status, all of which have expressed a real interest in collaborating with PA Members in the search for mutually beneficial opportunities. In this context, the PA may need to devise strategies to gain from such opportunities. A good example of such an opportunity lies in the Nordic countries, which have showed a clear interest in the Pacific Alliance. Bi-regional cooperation among these two integrated regions could unveil many different types of mutually beneficial opportunities such as technology and skill transfers that are worth exploring. The Pacific Alliance, if successful, will provide significant growth prospects for Member Countries in Latin America, but, considering the socioeconomic *externalities* of such regional growth, additional policies must be put in place in order to achieve wider sustainable development.

In brief, the formation of the Pacific Alliance presents challenges, but also great opportunities. Policy makers must, on one hand, work to overcome the challenges of asymmetric economic structures, low intra-regional economic dependency, poor physical infrastructure and shallow value chains and, on the other, take the necessary steps to promote greater institutionalization, a freer flow of human capital, homologation of academic titles, and so on.

If such challenges are overcome and the necessary decisions adopted, positive gains are expected to result in significant regional economic growth, the creation of global value chains, clear benefits in trade, FDI, increased productivity and significant job creation.